

NOTICE AND REQUEST FOR COMMENT**CHANGES TO PROPOSED NATIONAL INSTRUMENT 81-107 *INDEPENDENT
REVIEW COMMITTEE FOR INVESTMENT FUNDS* AND COMMENTARY
(SECOND PUBLICATION) AND RELATED AMENDMENTS****Prepared by the Canadian Securities Administrators****Introduction**

We, the members of the Canadian Securities Administrators (the CSA), are publishing for second comment a revised version of proposed National Instrument 81-107 (the Proposed Rule or the Rule), renamed *Independent Review Committee for Investment Funds*. This new name reflects the CSA's proposal to expand the applicability of the Proposed Rule from conventional mutual funds only to all publicly offered investment funds. We are also publishing a revised version of the companion policy to the Proposed Rule, which we call Commentary. We refer to the Proposed Rule and Commentary, together, as the Instrument.

We are also publishing for first comment:

- proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, Form 81-101F1 *Contents of Simplified Prospectus*, and Form 81-101F2 *Contents of Annual Information Form*;
- proposed amendments to National Instrument 81-102 *Mutual Funds* (NI 81-102) and Companion Policy 81-102CP *Mutual Funds*;
- proposed amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*;
- proposed amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)*;
- proposed amendments to National Instrument 44-101 *Short Form Prospectus Distributions* and Form 44-101F3 *Short Form Prospectus*;
- proposed amendments to National Instrument 81-104 *Commodity Pools*; and
- in some jurisdictions, certain local amendments.

Although the British Columbia Securities Commission (BCSC) supports some of the objectives of the Instrument, because of feedback the BCSC has received from industry, the BCSC is still considering whether adoption of the Instrument is appropriate and whether there are alternatives that might sufficiently address the proposed objectives in a more cost effective manner. The BCSC has additional questions they would like to ask about this issue. These questions are in the local cover notice published in British Columbia.

We expect the Proposed Rule to be adopted as a rule in each of Alberta, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario and New Brunswick, as a commission regulation in Saskatchewan, as a regulation in Québec, and as a policy in the remaining jurisdictions represented by the CSA. If British Columbia adopts it, the Proposed Rule would be adopted as a rule. The Commentary contained in the Proposed Rule will be adopted as a policy in each of the jurisdictions represented by the CSA.

Background

On March 1, 2002, the CSA released Concept Proposal 81-402 *Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers* (the Concept Proposal) that set out our vision for mutual fund regulation in Canada. It detailed our proposals to improve mutual fund governance and introduce a registration requirement for mutual fund managers.

On January 9, 2004, we published for comment the first version of the Proposed Rule and Commentary (the 2004 Proposal). The 2004 Proposal included the requirement for every publicly offered mutual fund to have a fully independent advisory body, called the Independent Review Committee (the IRC). The IRC would review all matters involving a conflict of interest or a perceived conflict of interest between the mutual fund manager's own interests and its duty to manage its mutual funds in the best interests of those funds. The objective of the 2004 Proposal was to ensure that every mutual fund had a minimum level of independent oversight in place.

Under the 2004 Proposal, the IRC was to bring its independent perspective to the decisions of the mutual fund manager that involved an actual or perceived conflict of interest for the fund manager. The IRC was to make a recommendation to the manager on the manager's proposed course of action. Its role was to provide 'sober second thought'.

The focus on conflicts of interest was deliberate. This was an area where, in our view, independent review mattered most, and would not place an undue burden on mutual fund managers who have no experience working with an independent advisory body. We also indicated our intention to eliminate the existing conflict of interest and self-dealing prohibitions in securities legislation once the Proposed Rule became effective.

For additional background information on the Concept Proposal and the 2004 Proposal, please refer to the notices published with those documents on the websites of members of the CSA.

Summary and Purpose

Purpose of the Proposed Rule

The Proposed Rule contemplates imposing a minimum, consistent standard of governance for publicly offered investment funds. Currently, there is no requirement that an investment fund have a governance body. Under the Proposed Rule, every investment fund that is a reporting issuer must have an IRC to oversee all conflict of interest matters – not just those subject to prohibitions or restrictions in securities legislation - faced by the fund manager in the operation of the investment fund.

We expect the Proposed Rule to enhance investor protection, by ensuring that the interests of the investment fund (and ultimately, investors) are at the forefront when a fund manager is faced with a conflict of interest, and by improving a fund manager's decision-making process in such situations through an upfront check on how the conflict of interest is resolved.

The Proposed Rule is also expected to contribute to more efficient Canadian capital markets, by permitting fund managers to engage in certain types of conflict of interest transactions without prior regulatory approval, provided the IRC approves. This will give fund managers greater flexibility to make timely investment decisions to take advantage of perceived market opportunities that they believe are in the best interests of the investment fund. The Proposed Rule addresses two types of conflicts of interest.

1. 'Business' or 'operational' conflicts faced by fund managers. These are conflicts of interest relating to the operation by the manager of its funds that are not specifically regulated under securities legislation, except through the general duties of loyalty and care imposed on the fund manager. These conflicts may include: the fund manager's decision to charge operational or incentive fees to the investment fund or to use affiliates in the operation of the investment fund, and the allocation of securities among funds in an investment fund complex.

2. 'Structural' conflicts faced by fund managers. These are conflicts of interest that result from proposed transactions by the manager with related entities of the manager, fund or portfolio manager currently prohibited or restricted by the conflict of interest and self-dealing provisions in securities legislation. Such conflicts may include: a fund manager's decision to purchase securities of an issuer related to it, or to trade securities amongst funds in an investment fund complex (inter-fund trade).

Summary of the Proposed Rule

The Proposed Rule applies to publicly offered investment funds. This includes mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

For any decision by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the fund manager must establish written policies and procedures that it must follow and refer the matter to the IRC for its review.

In the 2004 Proposal, all conflict of interest matters were referred to the IRC for a recommendation. The Proposed Rule now contemplates a two-pronged approach to IRC review.

A decision by the fund manager to engage in certain specified transactions currently prohibited

or restricted by securities legislation - inter-fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters - must receive the prior approval of the IRC to proceed. For any other proposed course of action by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the IRC must provide the fund manager with a recommendation, which the fund manager must consider before proceeding.

IRC approval is also required for certain changes to a mutual fund. In the consequential amendments to NI 81-102 which accompany the Proposed Rule, we specify that the IRC must approve two changes: a change in the auditor of the mutual fund, and a reorganization or transfer of assets of the mutual fund to a mutual fund managed by the same fund manager or an affiliate. We propose to eliminate the requirement for securityholder approval in these instances but continue to require a securityholder vote in other circumstances.

The Proposed Rule sets out the structure and functions of the IRC, as well as the obligations of the fund manager when faced with a conflict of interest. Prospectus disclosure and certain reporting obligations relating to the IRC are set out in the Proposed Rule and in the consequential amendments that accompany the Proposed Rule.

Contrary to the 2004 Proposal, we no longer propose to eliminate the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation. For inter-fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters, the Proposed Rule and the accompanying consequential amendments to NI 81-102 provide an exemption from obtaining regulatory exemptive relief, provided the IRC has given its approval to the fund manager to proceed.

We believe the Proposed Rule strikes the proper balance between management and oversight. The Proposed Rule still ensures that ultimate responsibility and accountability for the investment fund remains with the fund manager.

Form

The Proposed Rule is written in plain language. Commentary relevant to each section of the Proposed Rule appears immediately following that section for ease of reference. The purpose of the Commentary is to assist users in understanding and applying the Proposed Rule and to explain how we interpret a section of the Proposed Rule or expect the Proposed Rule to operate.

Summary of Feedback Received on the 2004 Proposal

We received 42 comment letters on the 2004 Proposal. Copies of the comment letters have been posted on the Ontario Securities Commission website at www.osc.gov.on.ca. Copies are also available from any CSA member. The names of the commenters can be found in Appendix A to this Notice.

As with the Concept Proposal, the 2004 Proposal elicited comments from a broad cross-section of the Canadian mutual fund industry and investors. We heard divergent views on almost every provision in the 2004 Proposal. We have considered all comments received and wish to thank all those who took the time to comment.

A summary of the comments we received on the 2004 Proposal, together with our responses, is also in Appendix A to this Notice.

Overarching themes

Several overarching themes emerged from the comments. The comments expressed on these themes resonated with us. As a result of the comments, we made a number of changes to the 2004 Proposal and raise the following new questions in this Notice. A summary of these themes is set out below.

The scope of the 2004 Proposal

Many mutual fund industry commenters urged us to expand the scope of the 2004 Proposal to all publicly offered investment funds. They said that fund managers of all types of investment funds face conflicts of interest, and that excluding certain funds will result in an uneven playing field between competing products vying for the same investor.

We also heard from some small mutual fund managers who expressed concern that the 2004 Proposal was not necessary for smaller mutual funds, particularly those that outsource many of the custody, processing, valuation and portfolio management functions, or have no structural conflicts of interest.

Our proposal to remove certain prohibitions in securities legislation

There was mutual fund industry support for the introduction of independent oversight by the IRC to be coupled with a relaxation of certain legislative restrictions to meet legitimate business needs. However, investors and investor advocates unanimously urged us not to replace existing conflict of interest and self-dealing prohibitions in securities legislation with an IRC whose recommendations are non-binding. They told us that the IRC's lack of "teeth" would render it ineffective in being a check and balance on a fund manager's conflicts of interest.

The need for more robust investor protection and effective monitoring of the fund manager

Investors and investor advocates unanimously told us that the requirement in the 2004 Proposal to disclose instances where the fund manager decides to proceed with an action without the positive recommendation of the IRC is not, on its own, an effective remedy, nor sufficient for robust investor protection. They said that the disclosure will probably come too late and may not be specific enough.

We also heard from industry, investors and investor advocates that the 2004 Proposal failed to provide a monitoring process or penalty for instances where the manager failed to refer conflict of interest matters to the IRC. These commenters also told us there was no guidance on what the IRC should or could do, if the fund manager refers very little to it for its review.

Our principles-based approach

Many industry commenters commended us for our commitment to principles-based regulation, and for the 2004 Proposal's user-friendly format. Yet, some commenters also asked us to provide greater specificity in the rule on certain matters. This was echoed by investors and investor

advocates who expressed concern about an approach that they said relied too much on solely principles. They suggested a combination of specific rules and principles would be more effective.

The uncertainty of the liability of IRC members

The majority of industry commenters expressed concern about the uncertainty of the liability of IRC members. They told us unlimited liability would affect the availability and cost of insurance for members, and would be a strong deterrent to potential members of an IRC. We were urged to somehow limit liability.

Our proposal to remove certain securityholder votes

Industry commenters supported the 2004 Proposal's removal of the requirement for the fund manager to obtain securityholder approval for certain changes to a mutual fund under Part 5 of NI 81-102, telling us securityholder approval of ongoing administrative matters is costly and not in investors' interests. However, investors and investor advocates unanimously urged us not to eliminate what they perceived as one of few investor rights.

Summary of Changes to the 2004 Proposal and Specific Requests for Comment

The Proposed Rule and Commentary differs from the 2004 Proposal in a number of significant ways. This section of the Notice describes the key changes. We have also raised specific issues for you to comment on in the shadowboxes below.

1. The Instrument now applies to publicly offered investment funds

An expanded scope

Under the 2004 Proposal, the Instrument would have applied only to conventional mutual funds and commodity pools.

We are now proposing that the Instrument apply to all publicly offered investment funds. This includes conventional mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds (including index-based funds) that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

In our view, some (if not all) of the conflicts of interest inherent in the management of a conventional mutual fund may exist in the management of all of these types of investment funds. Examples are: the fund manager's decision to charge operational and incentive fees to the investment fund, to use affiliates in the operation of the investment fund, and the allocation of securities among funds in an investment fund complex. Additionally, not all investment funds are currently prohibited in every jurisdiction from engaging in related-party and self-dealing transactions. For many of us, the perception of a governance 'gap' between the regulation of these products and the regulation of mutual funds and corporate issuers is difficult to reconcile.

We request comment on the expanded scope of the Proposed Rule and particularly seek feedback from those industry participants not included in the 2004 Proposal – scholarship plans, labour-

sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

Specifically, we would like to understand what conflicts of interest could exist in the management of these investment funds, the anticipated costs the Instrument could have on these funds, whether there are additional practical considerations for each of these investment fund structures that we should address, and what other mechanisms or approaches the fund managers of these investment funds use today or could use to address any conflicts of interest.

Smaller investment funds

The proposed Instrument continues to apply to smaller investment funds. We continue to believe that there are inherent conflicts of interest in the management of smaller investment funds that could benefit from the independent perspective brought to bear on such matters. We are, however, sensitive to concerns about the cost of an IRC for smaller funds.

In our view, IRC oversight for most smaller investment funds (where there are no structural conflicts of interest and where there may be fewer business conflicts, especially if many functions have been outsourced) would be much less burdensome than for larger investment funds, and therefore, less costly. However, we are also interested in considering other ways of managing conflicts of interest for smaller funds.

We request additional comment on the impact of including smaller investment funds in the Instrument.

Specifically, we would like feedback on our view that, with fewer conflicts of interest to address, an IRC will be less costly for smaller funds. We also seek specific data on the anticipated costs of complying with the Instrument for smaller investment funds, relative to the other costs of the investment fund.

We would also like to understand what commenters consider ‘smaller’ – is it a test based on the size of the investment fund? or the fund manager? or the number of investors in the investment fund?

The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.

2. The Instrument will keep existing conflict of interest and self-dealing prohibitions in securities legislation, and exempt specified transactions with IRC approval

Keeping existing rules

When we published the 2004 Proposal, we stated our intention to replace the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation with the introduction of IRC review.

In response to the comments, we now propose to retain the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation and provide exemptions in the Proposed Rule and NI 81-102 from the provisions that preclude certain specified transactions, provided that the fund manager has received the approval of the IRC to proceed. These transactions include: inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters.

We believe it is important to give fund managers some flexibility to engage in these types of transactions, which can be innocuous and beneficial to investors, without the expense and delay involved in seeking regulatory approval (which ultimately imposes costs on the investment fund and its securityholders). It is our view that oversight and approval of these transactions by an independent body that is familiar with the investment fund's operations, will ensure that any actual or perceived conflicts of interest are appropriately addressed. To date, members of the CSA have granted a number of exemptions from the prohibitions in securities legislation that restrict these transactions. Based on our own experiences, we are comfortable that IRC oversight and approval can be effective in addressing the conflicts of interest in these types of transactions. Over time, as the IRC members' familiarity with the operations of the investment fund and the fund manager grows, we expect that they will be well positioned to consider and understand all of the appropriate factors in deciding whether to approve such transactions.

The Proposed Rule specifies that existing conflict of interest waivers and exemptions that deal with matters regulated by this Instrument may not, after a specified date following the coming into force of the Instrument and implementation of the IRC, be relied on.

Other types of prohibited conflict of interest transactions with which we have less familiarity will continue to be prohibited under securities legislation and require regulatory exemptive relief to proceed.

We request comment on this approach and the exemptive provisions in the Proposed Rule and consequential amendments to NI 81-102.

Specifically, we would like feedback on whether the drafting of these provisions effectively captures the conflict of interest exemptions the CSA has granted to date, and whether the conditions accompanying the exemptions in the Proposed Rule and NI 81-102 are appropriate.

The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.

IRC approval

As outlined above, the proposed Instrument would require a fund manager to receive the prior approval of the IRC to proceed with inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters.

For any other proposed course of action by the fund manager that involves or may be perceived to involve a conflict of interest for the fund manager, the IRC will continue (as in the 2004 Proposal) to provide to the fund manager a positive or negative recommendation as to whether the action achieves a fair and reasonable result for the investment fund. The fund manager must

consider that recommendation before proceeding.

A fund manager must also receive IRC approval under Part 5 of NI 81-102 to proceed with certain changes to a mutual fund: a change of auditor of the mutual fund, and a reorganization or transfer of assets of the mutual fund to a mutual fund managed by the same fund manager or an affiliate.

A decision tree for different types of conflict of interest matters is included in Appendix B to this Notice.

We request comment on this approach.

3. The Instrument now provides the IRC with effective methods to oversee and report on manager conflicts of interest

As noted above, when we published the 2004 Proposal, we indicated our intention to replace the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation and instead require IRC oversight and an IRC recommendation to the fund manager as to whether the proposed transaction achieves a fair and reasonable result for the fund.

In response to the comments, we no longer propose to eliminate the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation. Instead, we intend under the Proposed Rule and NI 81-102 to exempt from the prohibitions and restrictions in securities legislation inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters, provided the fund manager has received the approval of the IRC to proceed, and to give the IRC the authority to stop the transaction.

For any other proposed course of action by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the IRC will give the fund manager its recommendation. In instances where the fund manager decides to proceed without the positive recommendation of the IRC, the Proposed Rule now gives the IRC the authority to require the fund manager to notify securityholders of the fund manager's decision at least 30 days before the effective date of the action.

In response to comments, we now also propose to require the IRC to prepare a report directed to securityholders at least annually, which describes what has transpired in the relevant time period. Among the matters the report must disclose is any instance where the fund manager proceeded to act without the positive recommendation of the IRC, or proceeded to act on a positive recommendation or approval but did not follow a condition imposed by the IRC in the recommendation or approval.

The Proposed Rule also requires that the IRC monitor and assess, at least annually, the adequacy and effectiveness of the fund manager's written policies and procedures related to conflict of interest matters, and the fund manager's compliance with the IRC's instructions on these matters.

Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities. This is intended to encourage members of the IRC to inform the regulator of any concerns – including concerns about a fund manager not referring conflict of interest matters to the IRC – not otherwise required by securities legislation

to be reported. The Proposed Rule further requires the IRC, in instances where the fund manager has proceeded with inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters, to report a breach of a specified condition imposed by securities legislation or by the IRC in its approval.

We request comment on this approach.

4. The Instrument now specifies the key governance practices we expect of the IRC and the manager

In response to the commenters who asked us to provide greater specificity in the 2004 Proposal on certain matters, we are now proposing that the Proposed Rule specify the minimum governance practices we expect of the IRC and the fund manager. Among these practices are: the appointment of a chair among the IRC members to act as the leader of the IRC and be the primary liaison between the IRC and the fund manager; the establishment of nominating criteria in the appointment of IRC members; the orientation and continuing education of IRC members; regular self assessments; and reporting obligations.

We believe this approach will create consistent minimum standards and practices among IRCs and fund managers, and will allow for a meaningful comparison by investors of investment funds.

We request comment on this approach. Specifically, we would like feedback on whether these provisions are best suited for the Proposed Rule or should be moved into the Commentary.

5. The Instrument addresses the liability of IRC members

The ultimate responsibility for the decisions made on behalf of the investment fund appropriately rests with the fund manager.

However, in response to the concerns raised about the potential unlimited liability of IRC members, we retained Carol Hansell of Davies Ward Phillips & Vineberg to provide us with advice on this issue. Based on this advice, the Instrument has been revised to emphasize the limited scope of the IRC's mandate, which in turn should limit the IRC's corresponding fiduciary duty and duty of care.

We were advised that by clarifying in the Instrument the very specific functions, duties and obligations of the IRC, we will have clarified that the IRC has a very limited role, particularly as compared to the role of corporate directors. We were also advised that the inclusion of a fiduciary duty and duty of care as well as language that mirrors certain defence provisions in corporate law statutes should serve to provide guidance to insurers and to the courts as to how we view the IRC's role.

A summary of Carol Hansell's analysis is available on the website of the Ontario Securities Commission at www.osc.gov.on.ca, and the website of the Autorité des marchés financiers at www.lautorite.qc.ca.

We request feedback on this approach.

6. The Instrument preserves investor votes for changes to the ‘commercial bargain’

In the 2004 Proposal, we proposed to remove the requirement for securityholder approval for all of the changes contemplated under section 5.1 of NI 81-102, except for a change in the mutual fund’s investment objectives and increases in the charges to the mutual fund or its securityholders.

With the benefit of the comments we received, we no longer propose to eliminate most of the securityholder approvals outlined in the 2004 Proposal. We believe that a securityholder vote should be required for proposed changes to a mutual fund that affect the ‘commercial bargain’ between the fund manager and investors.

We continue to propose, however, that a change in the auditor of a mutual fund and a reorganization or transfer of assets between affiliated mutual funds be permitted to proceed without securityholder approval, provided that the fund manager has received IRC approval. In our view, replacing securityholder approvals in these instances with approval by an independent body familiar with the investment fund’s operations will serve to adequately protect investors’ interests, while at the same time give the fund manager some relief from the expense and delay involved in holding securityholder meetings (which ultimately impacts the investment fund and its securityholders).

We request comment on this approach. Specifically, we would like feedback on the drafting of the proposed amendments to Part 5 of NI 81-102.

Anticipated Costs and Benefits

We believe that the cost savings estimates to fund managers from relaxing the restrictions on conflict of interest and self-dealing transactions published with the 2004 Proposal on the websites of the Ontario Securities Commission and Autorité des marchés financiers are still valid¹.

Upon review of the operational cost estimates of an IRC published with the 2004 Proposal, the Office of the Chief Economist at the Ontario Securities Commission (the Office of the Chief Economist) has concluded the cost estimates remain valid.

In the notice to the 2004 Proposal, the Office of the Chief Economist at the Ontario Securities Commission proposed to estimate some additional benefits and some of the cost savings associated with the Instrument.

Consistent with the methodology found in other studies on the subject, the Office of the Chief Economist has concluded, through the construction of a model of the most critical factors in determining fund performance, that the number of meetings of the IRC each year will not have a significant impact on an investment fund’s performance. As a result, the Proposed Rule specifies

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

only that the IRC meet at least annually. Of course, the IRC has the discretion to meet as frequently as it determines necessary.

The Office of the Chief Economist also proposed in the 2004 Proposal to estimate the benefits to a mutual fund of needing to take fewer matters to a vote of its securityholders. Through surveying the mutual fund industry, among the costs found to be associated with the voting procedure was the preparation and delivery of voting materials. The Office of the Chief Economist has determined the low end cost estimate per securityholder per meeting to be \$5 per securityholder. The high end cost estimate per securityholder per meeting to be \$20 per securityholder. We found the high end cost estimate is more representative of the typical costs that a mutual fund company would experience. However, to be conservative, the lowest cost estimate was used as a basis for calculating a mutual fund's cost savings per securityholder per meeting of not having to take a matter to a vote.

The Office of the Chief Economist estimates the benefit of removing a single meeting for the mutual fund industry to be \$254.35 million, based on 50.87 million securityholders in conventional mutual funds as of December 31, 2004. We are proposing that a change in the auditor of a mutual fund and a reorganization or transfer of assets between affiliated mutual funds be permitted to proceed without a securityholder vote, provided that the fund manager has received the approval of the IRC to proceed.

Smaller investment funds

We continue to believe that there are inherent conflicts of interest in the management of smaller investment funds that could benefit from the independent perspective brought to bear on such matters by an IRC. We remain, however, sensitive to the cost concerns surrounding an IRC for smaller investment funds.

In our view, the scope of IRC review for most smaller investment funds (where there are no structural conflicts of interest and where there may be fewer business conflicts, especially if many functions have been outsourced) would be much less burdensome than for larger investment funds, and therefore, less costly. In other words, we perceive the cost burden will be proportionate to the benefit of an independent perspective on conflict of interest matters.

The Office of the Chief Economist, based on a review of mutual funds with existing IRCs as a condition of exemptive relief, has found the range of operational costs of an IRC to be \$50,000 to \$250,000 per year. Given the limited scope of responsibility of these IRCs, we anticipate the costs of an IRC for a small investment fund will be similar.

Please see the questions we asked earlier under the sub-heading 'smaller investment funds'. Specifically, we would like feedback on whether commenters agree or disagree with our perspective on the cost burden of an IRC on smaller investment funds, and seek specific data on the anticipated costs of the Instrument for such funds.

Exchange-traded funds

In our view, some (if not all) of the conflicts of interest (business and structural) inherent in the management of a mutual fund exist in the management of closed-end funds and mutual funds

that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

For those exchange-traded funds that are “mutual funds” under NI 81-102, the restrictions in securities legislation on structural conflicts of interest apply - for example, restrictions on the purchases of securities of a related issuer, or inter-fund trading. For both NI 81-102 and non-NI 81-102 exchange-traded funds, business conflicts of interest exist- for example, a decision by the fund manager to use an affiliate in the operation of the fund, or the fund manager’s/affiliate’s direct ownership of units in the fund.

The Office of the Chief Economist, upon review of the operational cost estimates of an IRC published in the 2004 Proposal, has concluded that the cost estimates similarly apply to exchange-traded funds.

We note that many exchange-traded investment funds today have established advisory boards to provide an independent perspective on management decisions and advice to the fund manager.

Related Amendments

National Amendments

Proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (NI 81-101), Form 81-101F1 *Contents of Simplified Prospectus*, and Form 81-101F2 *Contents of Annual Information Form* are set out in Appendix C;

Proposed amendments to National Instrument 81-102 *Mutual Funds* (NI 81-102) and Companion Policy 81-102CP *Mutual Funds* are set out in Appendix D;

Proposed amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106) and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* are set out in Appendix E;

Proposed amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* (NI 13-101) are set out in Appendix F;

Proposed amendments to National Instrument 44-101 *Short Form Prospectus Distributions* (NI 44-101) and Form 44-101F3 *Short Form Prospectus* is set out in Appendix G; and

Proposed amendments to Multilateral Instrument 81-104 *Commodity Pools* (NI 81-104) is set out in Appendix H.

Local Amendments

We propose to amend elements of local securities legislation, in conjunction with the implementation of the Instrument. The provincial and territorial securities regulatory authorities may publish these proposed local changes separately in their jurisdictions.

Proposed consequential amendments to rules or regulations in a particular jurisdiction are in Appendix I to this Notice published in that particular jurisdiction.

Some jurisdictions will need to implement the Instrument using a local implementing rule. Jurisdictions that must do so will separately publish the implementing rule.

Unpublished Materials

In proposing the revised version of the Instrument, we have not relied on any significant unpublished study, report or other written materials.

We did, however, retain independent legal advice to help us resolve the concerns raised by commenters on the 2004 Proposal as to the liability of IRC members. A summary of the analysis provided to us is available on the website of the Ontario Securities Commission at www.osc.gov.on.ca and the website of the Autorité des marchés financiers at www.lautorite.qc.ca.

Request for Comments

We welcome your comments on the Proposed Rule, the Commentary and related amendments, including the changes made since the 2004 Proposal.

We have raised specific issues for you to comment on in the shadowboxes of this Notice. We also welcome your comments on other aspects of the Instrument, including our general approach and anything that might be missing from it. We remind you that the BCSC has included additional questions in the local cover Notice that they published in British Columbia. You can find those questions on the BCSC's website at www.bcsc.bc.ca in the Securities Law and Policy section.

We request your participation and input and thank you in advance for your comments.

Due Date

Your comments must be submitted in writing and are due by **August 25, 2005**. If you are not sending your comments by email, a diskette containing the submissions (in Windows format, Microsoft Word), should also be sent.

Where to Send Your Comments

Please address your comments to all of the CSA member commissions, as follows:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador

Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

Please send your comments **only** to the addresses below. Your comments will be forwarded to the remaining CSA member jurisdictions.

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8
Email: jstevenson@osc.gov.on.ca

Anne-Marie Beaudoin
Directrice du secretariat
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22 étage
Montreal, Quebec
H4Z 1G3
Fax: (514) 864-6381
Email: consultation-en-cours@lautorite.qc.ca

All Comments are Public

Please note that we cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. All comments will also be posted to the OSC website at www.osc.gov.on.ca to improve the transparency of the policy-making process.

Questions

Please refer your questions to any of the following CSA members:

Rhonda Goldberg
Senior Legal Counsel, Investment Funds
Ontario Securities Commission
Tel: (416) 593-3682
rgoldberg@osc.gov.on.ca

Susan Silma
Director, Investment Funds
Ontario Securities Commission
Tel: (416) 593-2302
ssilma@osc.gov.on.ca

Susan Thomas
Legal Counsel, Investment Funds
Ontario Securities Commission
Tel: (416) 593-8076
stthomas@osc.gov.on.ca

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

Christopher Birchall
Senior Securities Analyst
British Columbia Securities Commission
Tel: (604) 899-6722 or
1-800-373-6393 (in B.C. and Alberta)
cbirchall@bcscs.bc.ca

Bob Bouchard
Director, Corporate Finance and Chief Administrative Officer
Manitoba Securities Commission
Tel: (204) 945-2555
bbouchard@gov.mb.ca

Pierre Martin
Senior Legal Counsel, Direction des marchés des capitaux
Autorité des marchés financiers
(514) 395-0558, ext. 4375
pierre.martin@lautorite.qc.ca

Julie Hamel
Analyst, Direction des marchés des capitaux
Autorité des marchés financiers
Tel: (514) 395-0558, poste 4476
julie.hamel@lautorite.qc.ca

The text of the Proposed Rule, Commentary, and Related Amendments follows or can be found elsewhere on a CSA member website.

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APPENDIX A

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

Table of Contents

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

Summary of Comments

Background

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

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

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

		Comments	Responses
Part 1			
Section 1.2	<i>Mutual funds subject to Instrument</i>	01: Do you think this Instrument should apply either more broadly or more narrowly? If so, please explain why and in what manner.	
		<i>More broadly</i>	<i>CSA Response More broadly</i>

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	<p>Many mutual fund industry commenters urged us to have the 2004 Proposal apply to all publicly offered investment funds, as they equally share conflict of interest and self-dealing issues and compete for the same investor.</p> <p>To exclude such products, we were told, would result in an unlevel playing field between competing products.</p> <p><i>Status Quo or more narrowly</i> One commenter observed that the mandatory imposition of an independent review committee (“IRC”) is not necessarily the best or most practical way to achieve enhanced investor protection.</p> <p><i>ETFs</i> Two commenters supported the 2004 Proposal’s exclusion of closed-end funds and mutual funds listed and posted for trading on a stock exchange (“ETFs”).</p> <p>Yet, one of these commenters told us that if we were to include ETFs in the 2004 Proposal, we need to take into account their nature and different distribution structure.</p> <p><i>Other products</i> One commenter expressed concern that an IRC</p>	<p>We believe that conflicts of interest could exist in the management of all publicly offered investment funds.</p> <p>As a result, we agree we should consider further expanding the applicability of the 2004 Proposal beyond publicly offered conventional mutual funds to include scholarship plans, labour-sponsored or venture capital investment funds, exchange-traded mutual funds and exchange-traded closed-end investment funds. We have asked for comment on this proposed approach in our notice.</p> <p>The Proposed Rule continues to exclude pooled funds and CAPs.</p> <p><i>Status Quo or more narrowly</i> After much consideration, we continue to believe that there are inherent conflicts of interest in the management of investment funds that could benefit from the independent perspective brought to bear on such matters by an IRC.</p> <p>We are, however, sensitive to the cost concerns of an IRC for smaller investment funds. We have again asked for comment in our notice on the inclusion of small funds in the Proposed Rule.</p>
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		<p>is not appropriate for mutual funds distributed solely to portfolio managers for fully managed accounts managed by a registered adviser.</p> <p>Concern was also expressed by a few industry commenters that the 2004 Proposal is not appropriate for managers of small mutual funds, particularly those that employ a largely outsourced structure (e.g. custody, processing, valuation and portfolio management services) or have very few structural conflicts of interest.</p> <p>Still another commenter expressed reservations about the 2004 Proposal being expanded to capture capital accumulation plans (“CAPs”).</p> <p>Another commenter told us the 2004 Proposal should not apply to products sold via an offering memorandum, labour-sponsored investment funds, nor any other pooled product or investment fund with an existing board of directors.</p>	
Part 2			
Section 2.4	<i>Independence</i>	02: Do you agree with a ‘principles’ based definition of independence? Are there alternatives?	
		<p>While we received support for a principles based definition of independence, there were differing opinions on the accompanying Commentary.</p> <p>One commenter told us not to undermine the integrity and flexibility of the definition by providing overly specific Commentary, while</p>	<p><i>CSA Response</i></p> <p>We continue to believe a ‘principles’ based definition of independence will provide the greatest flexibility in establishing IRCs.</p> <p>We agree with the commenter who told us not to undermine the definition by providing overly specific Commentary. We have revised the Commentary in the Proposed Rule</p>

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		another urged us to consider more specific guidelines.	accordingly.
		<p>03: Do you consider the definition of independence in subsections 2.4(2) and (3) appropriate?</p> <p>Our proposal to model the independence test in the 2004 Proposal on Multilateral Instrument 52-110 <i>Audit Committees</i> (“MI 52-110”) received a mixed response.</p> <p>While one commenter supported conformity with Section 2.4 of MI 52-110, another commenter told us that the concept of independence applicable to audit committees is excessive for the responsibilities of the IRC, and instead we should look to MI 58-101 <i>Disclosure of Corporate Governance Practices</i>. (“MI 58-101”).</p> <p>Commenters with existing advisory or corporate board structures urged us to revise the definition of independence to permit members of existing advisory structures to act as members of the IRC. One commenter suggested we introduce a ‘materiality test’ as part of the definition so that the phrase ‘any relationship’ was qualified.</p> <p>Specifically, we were asked the following:</p> <p>1. To allow individuals that today act as the independent directors on the board of the fund manager to become the first members of the IRC, so long as these individuals have no other</p>	<p>in subsections 2.4(2) and (3) appropriate?</p> <p><i>CSA Response</i> We believe that we can describe the types of members we think would be appropriate through a ‘principles’ based definition of independence.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons), as found in MI 52-110 or proposed National Policy 58-201 <i>Corporate Governance Guidelines</i> (proposed NP 58-201).</p> <p><i>Who can act on the IRC</i> We were persuaded by the commenters who urged us to allow the independent members of existing independent advisory boards, existing investment fund boards, and IRCs established for exemptive relief purposes, for example, to act as the first members of the IRC.</p> <p>The Proposed Rule now allows individuals with existing relationships with the investment fund, manager or an entity related to the manager (as defined in the Proposed Rule) to act on the IRC, provided they otherwise meet the ‘principles’ based definition of independence.</p>

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		<p>material relationships within the meaning of the 2004 Proposal,</p> <p>2. To clarify Commentary 4 to allow independent directors of corporate mutual funds to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal,</p> <p>3. To allow members of a mutual fund’s trust governance board to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal,</p> <p>4. To allow independent directors of an affiliate to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal, and</p> <p>5. To allow individuals that today act as members of IRCs (created for exemptive relief purposes) to act as the first members of the IRC, even though they have accepted a consulting fee.</p> <p>A number of commenters also asked us to reconsider the concept of 100 percent independence for IRC members. We were directed to U.S. rules, as well as to academic literature, for discussions of the benefits of having non-independent directors on a fund board. It was suggested we permit one-third</p>	<p><i>Need for 100 percent independence</i></p> <p>The focused role of the IRC exclusively on the oversight of a manager’s conflicts of interest leads us to continue to believe that all members of the IRC must be independent of the manager, investment fund and any entity related to the manager.</p> <p>We were persuaded, however, by the commenters who</p>
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		<p>non-independent members.</p> <p>We were told that 100 percent independence is not a substitute for active engagement on key issues by an experienced person whose interests are aligned with the interests of long-term investors. Also, that the applicant pool for ‘unrelated’ financially literate individuals to fill IRCs will make it challenging to recruit qualified people.</p> <p>Finally, we were urged to preclude as an IRC member a person with a direct or indirect material relationship with an investment adviser to the funds or any other significant supplier to funds, and to consider precluding persons with personal friendships with the manager.</p>	<p>urged us to consider the benefits of non-independent directors on a board.</p> <p>Accordingly, the Commentary in the Proposed Rule now reinforces our view that the IRC is not prevented from meeting, or discussing matters with, the manager, representatives of management or other persons who may not be ‘independent’ as defined in the Proposed Rule, or from receiving oral or written submissions from such people.</p> <p>We continue to believe, however, that the independent members of the IRC should ultimately make their decisions in the absence of any representative of the manager or an entity related to the manager.</p>
		<p>04: Commentary 4 describes certain categories of persons we consider to have a material relationship with the manager or the mutual fund. Do you agree with the categories of precluded persons? Are there other categories that should be added?</p> <p>A number of industry commenters told us that Commentary 4 is overly specific and restrictive. They observed that it will disqualify most lawyers and accountants in firms with mutual fund manager clients even where the billings may be insignificant and the work is performed by other lawyers or accountants. One commenter further observed the mandatory</p>	<p>persons we consider to have a material relationship with the categories of precluded persons? Are there other categories</p> <p><i>CSA Response</i></p> <p>We were persuaded by the commenters who told us the prescribed material relationships described in Commentary 4 were overly restrictive.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons) in the definition of independence and in the Commentary.</p>

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		<p>language in Commentary 4 is inappropriate as the Commentary is not meant to have the force of law.</p> <p>These commenters urged us to introduce either a ‘materiality test’ or a de minimus threshold in Commentary 4, particularly as it refers to direct or indirect acceptance of “any consulting, advisory or other compensatory fee”.</p> <p>A number of commenters further told us that we should clarify the term “associate” in Commentary 4 so that family members who are not officers and directors of the manager, the mutual fund or an entity related to the manager will not be disqualified as prospective IRC members.</p> <p>Finally, one commenter suggested that the 2004 Proposal should specify the IRC’s responsibility to adopt policies on how members should conduct themselves if they are perceived to be in a conflict.</p>	<p>While a “material relationship” may include the direct or indirect acceptance of fees, the Commentary to the Proposed Rule now specifies that only those relationships which could reasonably be perceived to interfere with the exercise of a member’s independent judgment, should be considered a “material relationship” within the definition of “independence”, barring membership on the IRC.</p> <p><i>IRC conduct</i></p> <p>The Commentary to the Proposed Rule now specifies our expectation that the IRC’s charter include policies and procedures on how members are to conduct themselves if in a conflict of interest, or perceived to be in a conflict of interest, with a matter being considered by the IRC.</p>
		<p>05: Is the ‘cooling off’ period in Commentary 4 an appropriate period? Too long? Too short?</p> <p>While one commenter told us a three year period was appropriate, many more told us they considered it too long. A number of commenters suggested a period of one year as an appropriate ‘cooling off’ period.</p> <p>We were urged by four commenters to introduce</p>	<p><i>CSA Response</i></p> <p>Since categories of prescribed material relationships (precluded persons) are no longer included in the Proposed Rule, the ‘cooling off’ period previously specified in the 2004 Proposal has also been deleted.</p> <p>The Proposed Rule now allows individuals with existing relationships with the investment fund, manager or an entity</p>

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		<p>the “prescribed period” concept found in MI 52-110, so that individuals will only be considered to be non-independent if they have or have had a specified relationship during the prescribed period that begins after the 2004 Proposal becomes final.</p> <p>We were told that individuals should not be barred from acting as IRC members because they are tainted by relationships that pre-dated the 2004 Proposal.</p>	<p>related to the manager (as defined in the Proposed Rule) to act on the IRC, provided they meet the ‘principles’ based definition of independence.</p> <p>We would expect that a determination of whether an individual has a direct or indirect material relationship with the manager, investment fund, or an entity related to the manager in the Proposed Rule, to include a consideration of both the individual’s past and current relationships with these entities. This expectation is articulated in the Commentary of the Proposed Rule.</p> <p>We recognize that the ‘principles’ based definition of independence in the Proposed Rule has the effect of potentially barring an individual’s participation on an IRC for a relationship which extends beyond the previously prescribed ‘cooling off’ period. We consider this outcome appropriate.</p>
<p>Section 2.8</p>	<p><i>Liability</i></p>	<p>06: We were told that without a limit on the liability of members of the independent review committee, insurance coverage for the members would be difficult to obtain. What are your views, given the responsibilities the IRC will have under this Instrument?</p> <p>While one commenter remarked that the fact that the fund manager has final decision-making power would seem to place most of the liability on the manager, other commenters told us that while obtainable at a high enough price, insurance coverage has become increasingly difficult to obtain and they expect coverage will continue to increase.</p> <p>One of these commenters further remarked that the broader the scope of conflicts overseen by</p>	<p>of members of the independent review committee, insurance coverage for the members would be difficult to obtain. What are your views, given the responsibilities the IRC will have under this Instrument?</p> <p><i>CSA Response</i> Upon review and consultation, we believe insurance coverage for members of IRCs will be obtainable. While we recognize that the novelty of the IRC structure may initially create added cost, we believe the focused mandate of the IRC, coupled with the existence of a number of independent advisory committees – including IRCs created in response to exemptive relief - will negate some of the costs associated with a new structure.</p> <p>To give guidance to potential IRC members (and potential insurers), we have revised the Proposed Rule to clarify the</p>

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		<p>the IRC, the more difficult or expensive it will likely be to obtain insurance coverage.</p> <p>Two other commenters told us that unlimited liability will likely mean much greater use and reliance by the IRC of professional advisers, which will increase costs of the IRC.</p>	<p>limits on the IRC's mandate and its standard of care.</p>
		<p>07: Will potential members be deterred from sitting on the independent review committee without such a limitation?</p> <p>Industry commenters unanimously told us that undefined liability and the uncertainty of availability of D&O insurance will be a strong deterrent to potential members of an IRC.</p> <p>One law firm commented that they would be reluctant to advise a client to join an IRC if there was no limit set on personal liability.</p> <p>Not surprisingly, we were urged by these commenters to somehow limit liability. One commenter remarked that the difference in potential liability of a member of an IRC and that of a director of an issuer is striking and not justifiable.</p> <p>One commenter suggested that the Commentary to the 2004 Proposal state that contractual limitations of liability for IRC members could be provided for in the trust indentures of mutual funds.</p>	<p>on the independent review committee without such a</p> <p><i>CSA Response</i> We were sympathetic to the commenters who told us unlimited liability will act as a deterrent for potential members of an IRC. We engaged external legal counsel to assist us with this issue.</p> <p>As a result, the Proposed Rule has been revised to clarify the limits on the IRC's mandate and its duty of care. We have been advised that these drafting changes (which use terminology similar to the CBCA) sufficiently limit the liability of members of the IRC to their mandate and increase the likelihood of a member's ability to invoke the common law defences available to directors.</p>

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

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	<p>certain fund changes. While some commenters supported the relaxation of the requirement to hold some securityholder meetings, others objected to the removal of what they perceived as one of so few investor rights, and the dilution of investor protection.</p> <p>The fund change we received the most response on was an increase of fees or expenses to the mutual fund.</p> <p>While one commenter supported referral to the IRC of increases in management fees, others told us referral to the IRC should not occur when the increase in fees involves a third party, or when it involves an allocation of expenses between funds.</p> <p>Still another commenter disagreed with our view that a change in a fee or expense is fundamental to the “commercial bargain” with investors. This commenter, and three others, told us that a manager should be allowed to increase or introduce a fee without a securityholder vote, provided investors have notice and are allowed to redeem without payment of any fees.</p> <p>These commenters further remarked that securityholder meetings for the approval of ongoing administrative matters are costly and not in the best interests of investors.</p> <p>Finally, one commenter suggested Section 3.2 additionally require the IRC to review a change</p>	<p>voting. This view is articulated in the Commentary to the Proposed Rule</p> <p><i>Removing a securityholder vote</i> We were persuaded by the commenters who told us they viewed the removal of the securityholder right to vote for certain changes to a mutual fund in section 5.1 of NI 81-102 as a dilution of investor protection.</p> <p>Accordingly, the consequential amendments to NI 81-102 which accompany the Proposed Rule removes only the securityholder vote for change of auditor and those mutual fund reorganizations or transfers of assets where the mutual funds are managed by the same manager or an affiliate, and meet the pre-approval criteria in section 5.6 of NI 81-102.</p> <p>After much consideration, we continue to believe that the remaining ‘fundamental changes’ under section 5.1 of NI 81-102 make up the ‘commercial bargain’ between investors and the mutual fund for which a securityholder vote must remain.</p>
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		<p>in manager when the new manager is affiliated with the existing manager. This, it was remarked, represents a business conflict, since a fund sponsor is effectively choosing to realize higher operating margins by firing an external portfolio manager and hiring a related manager in its place.</p> <p>We also received comment on some technical drafting concerns with Section 3.2.</p> <p>First, three commenters remarked that the 2004 Proposal does not acknowledge the current exemptions contained in Part 5.3 of NI 81-102. These commenters submitted the 2004 Proposal should track the exemptions.</p> <p>Second, commenters told us that unlike NI 81-102, Section 3.2 does not specify “change in control” of a manager, only “change of manager”. They asked us to be consistent throughout the 2004 Proposal when referring to changes of manager and changes in control of manager.</p> <p>Third, one commenter urged us to adopt a more practical approach to address changes in control of a manager, remarking there are logistical problems with the requirement in NI 81-102 to give securityholders 60 days’ notice.</p>	<p><i>Discrepancies with NI 81-102</i> We agree with the commenters who told us our drafting must be consistent with Part 5 of NI 81-102.</p> <p>Accordingly, the consequential amendments to NI 81-102 which accompany the Proposed Rule clearly refer to section 5.1. The exemptions in section 5.3 remain unchanged.</p> <p>We note, however, that the definition of a “conflict of interest matter” in the Proposed Rule makes a referral to the IRC of even the changes exempted from a securityholder vote in section 5.3 possible. We believe this is the right result as IRC oversight is intended to apply to any conflict of interest matter.</p> <p>Finally, we do not propose within the scope of this project to review the 60 day notice requirement in Part 5 of NI 81-102.</p>
		<p>09: Does the right to transfer free of charge to another mutual fund managed by the same manager need to be mandated or is it industry practice?</p>	

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		<p>While three commenters supported the inclusion in the 2004 Proposal of the right to transfer free of charge in the situations noted, one commenter objected, stating that the right to transfer free of charge is a business decision of the fund complex, and is disclosed prior to an investor's investment.</p> <p>Of the commenters supportive of the right to transfer, one remarked that the funds available to transfer to, or the investor's objectives, may make the right to transfer an unsatisfactory option. This commenter suggested the 2004 Proposal require a limited period during which an investor can leave without penalty, including deferred sales charges. This sentiment was echoed by another commenter, who told us investors should not have to bear deferred sales charges if the 2004 Proposal is intended to permit them to redeem because of changes that the manager decides to make.</p> <p>Other commenters sought clarification of whether 'transfer free of charge' includes switch fees, even those charged by a dealer outside the control of the manager, and whether investors are also allowed to redeem and take cash. These commenters told us the 2004 Proposal should specify our intention.</p>	<p><i>CSA Response</i></p> <p>The Proposed Rule no longer mandates a special right to transfer free of charge to another fund when the manager does not follow a recommendation by the IRC with respect to a change contemplated under section 5.1 of NI 81-102.</p> <p>Upon further consideration, our view is that securityholders should have the same protections and remedies afforded to them for any management decision.</p> <p>The Proposed Rule now specifies that in instances where the manager intends to proceed without the positive recommendation of the IRC, the IRC has the discretion to require the manager to give immediate notice of its decision to proceed to the securityholders of the investment fund.</p> <p>The Proposed Rule now also requires that the IRC prepare a report to securityholders, at least annually, of events that have transpired for a relevant time period. Required to be in this report are any instances where a manager proceeded to act without the positive recommendation of the IRC.</p>
Section 3.3	<i>Inter-fund trades</i>	10: Do you agree with our proposals for inter-fund trading (in particular, the scope of the provisions)? If not, please explain.	<i>CSA Response</i>

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

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		illiquid equity securities should be the closing price for those securities on their primary exchange.	to be appropriate for illiquid securities.
		13: Should the current market price of illiquid equity securities on an exchange be treated differently from over-the-counter equity securities?	
		We received no comments on this question.	<i>CSA Response</i> We have concluded the pricing should not be different.

Other Comments on the Rule

General Comments			
	<i>Support for Rule</i>	<p>Support for the 2004 Proposal’s revised focus on conflicts of interest and the role of the IRC was divided almost unanimously among industry and investor commenters.</p> <p><i>Supportive</i> While one industry commenter told us the 2004 Proposal is not justified, as there is no evidence of widespread conflicts of interest adversely affecting investors, the vast majority of industry commenters supported our goal of enhanced investor protection and investor confidence through the use of independent oversight.</p> <p>Those supportive of the 2004 Proposal told us the focus on conflicts of interest targets the most appropriate area of governance oversight, and allows the IRC to focus on the</p>	<p><i>CSA Response</i> We believe an IRC, focused exclusively on conflicts of interest facing the manager, will provide independent review of an area that could benefit from independent oversight. We expect the role of the IRC to evolve with time and expect industry practices to develop to support and enhance this regime.</p> <p>We were persuaded, however, by the commenters who urged us to reconsider the parameters of the IRC’s authority.</p> <p>Accordingly, the Proposed Rule now requires the manager to obtain the approval of the IRC before proceeding with certain types of prohibited conflict of interest or self-dealing transactions (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters) that would otherwise require the approval of the securities regulatory authorities or regulators.</p>

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	<p>very issues that are most important to investors. They also remarked that fund governance is not a panacea and they do not believe a very broad mandate will be more effective in protecting investor interests.</p> <p>One industry commenter told us they believe the IRC can be an important means of achieving objectivity and should provide a measured deterrent to both individuals and entities that seek to circumvent their fiduciary duties.</p> <p><i>Opposed</i> Investor commenters were unanimous in their opposition to the 2004 Proposal’s revised focus on conflicts of interest and the role of the IRC. Many of these commenters urged us to withdraw the 2004 Proposal, saying that it undermines investor protection and erodes investor confidence in the safety and soundness of mutual funds.</p> <p>These commenters warned that without explicit authority to impose decisions and to forward concerns to regulators, the IRC will be ineffective in mitigating conflicts of interest. They told us they were disappointed and disturbed that the 2004 Proposal is “significantly gutted” from the Concept Proposal and does not go far enough.</p> <p>Two investor commenters told us the U.S. fund scandals had led to their “decreasing trust and faith” in those in industry fulfilling</p>	<p>Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC to report instances where it finds (or has reasonable grounds to suspect) breaches of the matters under its review.</p>
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		<p>their fiduciary responsibilities and remarked that the industry should not be allowed to “police itself”.</p> <p>Objection to the 2004 Proposal was not exclusively from investors. An independent board of directors of a mutual fund also expressed concern for the reduced role of the IRC, stating it removes important protections for mutual fund investors.</p>	
	<p><i>Relationship to loosening product regulation</i></p>	<p>Support for our proposal to remove the existing self-dealing and conflict of interest prohibitions contained in NI 81-102 and provincial securities legislation was similarly divided among industry and investor comments.</p> <p>Some industry commenters supportive of the 2004 Proposal stressed that enhanced independent oversight must be coupled with harmonized product regulation, instead of being an ‘add-on’ to the existing regulatory regime. They told us that they need to review our proposed revisions to the existing product regime to quantify and comprehend the impact of the 2004 Proposal.</p> <p>Two other commenters told us that to recognize the benefits demonstrated in the OSC’s cost-benefit analysis, existing conflict of interest prohibitions in securities regulation must be repealed contemporaneously with the 2004 Proposal coming into force.</p>	<p><i>CSA Response</i></p> <p>We continue to believe that existing conflict of interest prohibitions in securities regulation can, and should, be rethought with the introduction of a mandatory IRC. However, we were persuaded by those commenters who argued that introducing an IRC does not remove the need for the existing prohibitions on self-dealing and other related party transactions in securities legislation.</p> <p>As a result, the Proposed Rule is now drafted on the premise that the existing self-dealing and conflict of interest prohibitions in securities regulation will remain. For the manager to proceed with certain types of prohibited transactions without regulatory approval (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters), prior approval of the IRC must be obtained.</p> <p>These exemptions represent those conflicts of interest which we (in part, based on our experience to date with exemptive relief), believe can be appropriately dealt with by IRC approval and oversight. We expect that the types of prohibited conflict of interest matters dealt</p>

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		<p>We were also asked to eliminate redundancy between the review responsibilities of the IRC and requirements of existing rules that will not be subject to regulatory relaxation.</p> <p>Investor commenters unanimously told us introducing an IRC does not remove the necessity for the existing prohibitions on self-dealing and other related party transactions in securities legislation. The fundamental problem of the 2004 Proposal, we were told, is the removal of existing prohibitions on related party transactions and replacing them with an IRC whose authority is non-binding.</p> <p>These commenters remarked that it is highly unlikely an IRC with no powers is a sufficient check or balance. One commenter said they had no problem with self-regulation being added to an existing regulatory structure but not instead of it.</p> <p>Concern was also expressed that the removal of existing prohibitions will not provide regulators with regulatory oversight, and may make it more difficult for investors to establish a manager’s breach of its fiduciary obligations.</p>	<p>with in this manner will continue to evolve.</p>
	<p><i>Principles-based regulation</i></p>	<p>While some commenters commended us for our commitment to ‘principles’ based regulation, and for the 2004 Proposal’s “user-friendly” format, others expressed some</p>	<p><i>CSA Response</i> We agree with the commenters who told us they support a mix of ‘principles’ and ‘prescriptive’ regulation. While we continue to believe in more flexible regulation, the Proposed Rule now contains</p>

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	<p>concern regarding this regulatory approach.</p> <p>Four investor commenters remarked that at a time when the U.S. securities regulators are enforcing stricter regulation to deter abuses discovered in the U.S. mutual fund industry, it was not appropriate for us to be relaxing rules or removing ourselves from the oversight of investment funds. Another commenter expressed concern for the message the 2004 Proposal sends to the investing public when confidence in the system already low.</p> <p>These commenters referred us to past reports which rejected relying solely on a principles-based approach to regulating conflicts of interest. They told us these concerns still exist, and that a combination of specific rules and principles would be effective.</p> <p>One commenter asked how we expected to enhance compliance efforts absent any explicit requirements against which to measure compliance.</p> <p>Still another commenter stated that without any evidence that a principles-based system is more effective, a more gradual shift to a principles-based regime – incorporating a mix of principles and rules - should occur.</p> <p>Industry commenters also expressed concern at the inclusion of large portions of the 2004 Proposal as Commentary. We were told</p>	<p>certain minimum requirements on the structure and functions of the manager, investment fund and the IRC, where we considered it appropriate.</p> <p>The Commentary to the Proposed Rule has been amended to remove any mandatory or prohibitive language.</p>
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		<p>mandatory or prohibitive language in Commentary is inappropriate because it is not intended to have the force of law.</p> <p>To provide certainty for fund managers and IRCs, these commenters asked that significant sections of Commentary be moved into the 2004 Proposal. One commenter remarked that matters considered important and necessary for the 2004 Proposal should be in the 2004 Proposal, not in Commentary.</p>	
	<p><i>Costs and Cost-Benefit Analysis (“CBA”)</i></p>	<p>A number of commenters told us that the cost-benefit analysis (the “CBA”) does not adequately address some of the significant cost implications of the 2004 Proposal, such as costs associated with the insurability and compensation of IRC members, the costs of professional advisers to the IRC, and the costs related to the inter-fund trading regime proposed. We were told that IRC candidates may gravitate to firms that offer high compensation and the most resources, making IRCs more costly.</p> <p>One commenter told us that if the responsibilities of the IRC could be limited to a more defined list of conflict situations, the costs incurred by the funds should be lower.</p> <p>Another commenter suggested that we consider the costs incurred by investment funds in the United States who have boards.</p>	<p><i>CSA Response</i></p> <p>We believe that investment funds and securityholders could benefit from the Proposed Rule, which is designed to more effectively deal with the conflicts of interest faced by the manager.</p> <p>Accordingly, while we recognize that the Proposed Rule will impose some additional costs on investment funds, we disagree with some of the cost concerns raised by commenters.</p> <p>Our view is that the focused mandate of the IRC and the current existence of a number of independent advisory committees, boards and IRCs (created voluntarily or in response to exemptive relief), will negate some of the insurance costs associated with an unknown structure.</p> <p>We also expect that the costs to ‘print’, a condition to inter-fund trading under the Proposed Rule, will be substantially lower than the costs normally associated with market transactions through a dealer.</p>

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		<p>It was also suggested that each of the provisions in the 2004 Proposal ought to have a cost-benefit analysis evaluation.</p> <p>A few commenters also questioned the cost versus benefit of introducing an IRC. We were asked to remain sensitive to the fact that the increasing impact of cost pressures on mutual funds will result in higher costs to investors and serve to reduce the overall competitiveness of the industry. One commenter told us it is not acceptable to burden lower to middle income investors (to whom the mutual fund industry provides investment opportunities) with increased costs and reduced performance.</p> <p>In response to industry’s cost concerns, one commenter, questioning the benefit of trailing commissions to investors, suggested fund managers abolish trailer fees to pay for the costs of an IRC.</p> <p>Finally, we were reminded by a number of commenters that small fund managers, who are less likely to be related to financial service providers, will benefit less from the mandatory imposition of an IRC.</p>	<p><i>Small investment funds</i> Regardless of the size of the investment fund, conflicts of interest are inherent in the management of all investment funds. Small investment funds and their securityholders could benefit from the independent perspective brought to bear on such matters by IRC oversight.</p> <p>We are, however, sensitive to the cost concerns of an IRC for small investment funds.</p> <p>Under the Proposed Rule, we believe that with no</p>
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			<p>structural conflicts of interest and fewer business conflicts of interest (where the investment fund employs a largely outsourced structure), the scope of IRC review could be much less burdensome than for the larger investment fund complexes, and therefore, less costly. For example, the mandate of the IRC of a small investment fund will be simpler, and less costly, than for a larger investment fund.</p> <p>We have again asked for comment in our notice on the inclusion of small funds in the Proposed Rule and specifically, on the viewpoint articulated above.</p>
	<p><i>Educational Requirements for IRC members</i></p>	<p>Industry and investor commenters alike impressed upon us the need for minimum proficiency standards and ongoing education programs for IRC members. We were told “industry literacy standards”, particularly of capital markets and the mutual fund industry, were important.</p> <p>Commenters’ suggestions included that the CSA implement education standards, not unlike existing legislation for audit committees, and that regulators and industry set up education programs for new members of IRCs.</p> <p>One commenter suggested the statutory requirements of directors of incorporated companies should apply, while another told us that we should monitor the activities of IRCs until we are satisfied they are capable of appropriately discharging their</p>	<p><i>CSA Response</i></p> <p>We were persuaded by the commenters who urged us to consider specifying minimum education requirements for IRC members. We agree that to be effective, members of the IRC must understand the nature, operation, and business of both the manager and the investment fund, the role of the IRC, and the contribution individual members are expected to make.</p> <p>Accordingly, the Proposed Rule now sets out minimum standards for the orientation and continuing education the manager must provide to members of the IRC. We anticipate that industry practice standards may also develop in this area.</p>

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		responsibilities.	
	<i>Additional suggestions</i>	<p>We received a few additional suggestions.</p> <p>One commenter told us auditors could benefit from “independence” in their review, and suggested the 2004 Proposal impose separate audit firms for the fund manager and for its mutual funds.</p> <p>Another commenter suggested we require independent auditors to pass opinion on the internal controls of the manager.</p> <p>We were also provided with a list by an investor advocate of other investor protection initiatives the CSA should institute instead of the 2004 Proposal. Among them: a mutual fund investor protection fund, a prohibition on frequent trading, a requirement that fund companies publicly disclose their proxy share voting policies, and a limit on soft dollar transactions.</p>	<p><i>CSA Response</i> <i>Auditor independence and advice to IRC</i></p> <p>The definition of a ‘conflict of interest matter’ in the Proposed Rule may, in certain instances, capture a manager’s decision to engage its auditor for the investment fund it manages. The Proposed Rule authorizes the IRC to employ independent counsel and other advisers it determines useful or necessary to carry out its role. We continue to believe a flexible approach to the IRC’s use of external advisers is appropriate.</p> <p><i>Other initiatives</i></p> <p>While not within the scope of the Proposed Rule, a number of the investor protection initiatives raised by this commenter are currently underway.</p>
Part 1			
Section 1.3	<i>Multiple class mutual funds</i>	Two commenters questioned the desirability of introducing the use of terminology different from section 1.3 of NI 81-102.	<p><i>CSA Response</i></p> <p>Upon review, we agree with these commenters. Accordingly, the Proposed Rule no longer references multiple class funds.</p> <p>The Proposed Rule would apply to multiple class mutual funds in the same manner as NI 81-102 applies such classes or series.</p>
Part 2			
Section 2.1	<i>Independent</i>		<i>CSA Response</i>

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	<p><i>review committee for a mutual fund</i></p>	<p>While two commenters told us that they appreciated the flexibility provided to fund managers to structure an IRC that works best for the funds that it manages, another commenter remarked that the alternative structures suggested in the Commentary, except for a committee of individuals independent of the fund manager, will generally not be practicable options.</p> <p>Although one commenter asked that the Commentary clarify that a mutual fund may establish multiple IRCs if it wishes, another commenter told us multiple IRCs within the same mutual fund complex is undesirable because: there should be uniformity of policies and procedures for all funds managed by the same manager, fund expenses would increase if several IRCs were to exist, and it would compound anticipated difficulty for fund complexes to identify and attract suitable members for IRC.</p> <p>Two commenters also remarked that confidentiality and competition issues make it unlikely that fund managers would consider an IRC acting for two or more unrelated fund complexes.</p> <p>One commenter urged us to explicitly permit in the 2004 Proposal (not Commentary) that an IRC of more than 3 members may</p>	<p><i>The structure and number of IRCs</i></p> <p>We think it is important to provide flexibility to funds to determine how to best structure their IRC.</p> <p>With the Proposed Rule no longer including categories of precluded material relationships in the definition of ‘independence’ for IRC members, a manager is able to choose the independent members of an existing independent advisory board, an existing investment fund board, or IRC, for example, to act as the first members of the IRC under the Proposed Rule. These are practical options for funds with existing IRC-like structures.</p> <p>There may be instances where the manager would consider that the objectives or strategies of an investment fund or group of investment funds warrant a separate IRC. The Commentary to the Proposed Rule specifies that the manager may establish one IRC for all investment funds it manages, or establish an IRC for each of its investment funds, or groups of its investment funds.</p> <p><i>The IRC’s relationship to existing structures</i></p> <p>Upon review, we did not think it was necessary to</p>
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		<p>delegate its responsibilities to a committee of at least 3 members, so that an entire ‘board’ is not liable for the decisions taken by the IRC.</p> <p>Another commenter remarked that the 2004 Proposal does not sufficiently delineate the required scope of reporting by, or decision-making authority of, an IRC in relation to existing governance structures (boards) already in place.</p> <p>We were also told by a commenter that they disagreed with our view that there was a large pool of potential IRC members.</p>	<p>explicitly permit the specific arrangement contemplated by the commenter.</p> <p>While the Proposed Rule sets out the reporting relationship between the manager and the IRC, we would expect the manager, in the course of selecting an IRC structure suitable for its investment funds, and when assisting in the development of the IRC’s charter, to consider any further reporting obligations the manager wants from the IRC.</p> <p><i>Applicant pool for IRC members</i> Upon review and consultation, we continue to believe that there will be a sufficient pool of potential IRC members.</p>
<p>Section 2.2 Section 2.3</p>	<p><i>Term of Office</i> <i>Initial Appointment</i> <i>Composition,</i> <i>Term of office</i> <i>and vacancies</i></p>	<p>One commenter disagreed with a maximum term of 5 years, suggesting IRC members be permitted to serve 7 years. This commenter also remarked that a member who has served the maximum allowable term should not be eligible for reappointment until two years have elapsed.</p> <p>We were also asked to specify a maximum number of years that can be served by any one director, with two commenters suggesting a 10 year cap, citing concern for members becoming entrenched both in viewpoints and the desire to stay.</p>	<p><i>CSA Response</i> While the Proposed Rule specifies a maximum 5 year term, it does not limit the number of terms that an IRC member may serve. We consider the members of the IRC, who appoint replacement members after the manager’s initial appointment, to be best-positioned to judge the effectiveness of a fellow member.</p> <p>We would expect the annual self-assessment and committee assessment by IRC members now required by the Proposed Rule to address whether the term of a member was problematic. We also believe that this is an area where best practices will develop.</p>

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		<p>One commenter suggested the 2004 Proposal clarify how initial terms should be structured so as to achieve staggered terms.</p>	
	<i>Appointments</i>	<p>Comments on appointments to the IRC were split into three groups.</p> <p>One group of comments supported the 2004 Proposal's requirement for the IRC to appoint replacement members after the fund manager's initial appointments. However, we were also told by one commenter that the 2004 Proposal should provide the manager with a forum to object such nominations, and another commenter remarked that the 2004 Proposal should provide for investors to participate in the appointment of IRC members.</p> <p>The second group of commenters disagreed with the approach in the 2004 Proposal. They told us that the fund manager should be solely responsible for all IRC appointments, since the best interests of the mutual fund ultimately lies with the fund manager, and the manager is as interested as securityholders in ensuring that an IRC is comprised of qualified, competent people.</p> <p>The third group of commenters remarked that the manager and IRC should appoint and remove members jointly.</p>	<p><i>CSA Response</i></p> <p>We believe the IRC's appointment of members (after the manager's initial appointment), is best-suited to foster an independent-minded IRC focused on the best interests of the investment fund. We consider the process of self-selection of the IRC to be consistent with good governance practices.</p> <p>Some commenters suggested the manager should have some involvement in the selection process and we agree.</p> <p>Accordingly, the Proposed Rule now requires appointments of members of the IRC to meet certain minimum nominating criteria, which we would expect the manager and IRC to develop together.</p> <p>The Commentary to the Proposed Rule further specifies our expectation that the IRC would consider the manager's recommendation in selecting its members.</p>
Section 2.4	<i>Independence</i>		<i>CSA Response</i>

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	<p>Many commenters asked us to clarify in Commentary 3 whether “material relationship” includes individuals who have an investment in the particular mutual fund. We were told such individuals otherwise qualified should not be prevented from becoming a member of an IRC, as ownership serves to align the interests of the IRC with the mutual funds.</p> <p>One commenter even suggested all IRC members be required to own securities in the mutual funds they review, equal to a minimum of one year’s fees, in order to align their interests with those of securityholders.</p> <p>Two commenters disagreed with the 2004 Proposal permitting the board of a trust company acting as trustee for the fund to become members of the fund’s IRC. While another commenter supported this approach, still another told us that the board’s first responsibility is to the trust company, and stressed the importance of true independence of the manager.</p> <p>We were also asked by a commenter to specify in Commentary 6 whether an IRC should adopt policies and procedures requiring disclosure of a member’s and close relatives’ interests in the funds. The commenter remarked that IRC members should recuse themselves from discussions relating to funds in which they hold substantial interests.</p>	<p>As noted above, we believe that we can describe the types of members we think would be appropriate through a ‘principles’ based definition of independence.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons), as found in MI 52-110 or proposed NP 58-201.</p> <p><i>Ownership of securities of the investment fund</i> While the Commentary specifies that a “material relationship” within the definition of “independence” may include ownership, we would expect only those relationships which might reasonably be perceived to interfere with the exercise of a member’s independent judgment to be considered material.</p> <p><i>Disclosure of interests</i> The Commentary to the Proposed Rule has been revised to specify our expectation that an IRC’s written charter include policies and procedures that describe how members of the IRC are to conduct themselves when in a conflict of interest, or perceived conflict of interest, with a matter being considered or about to be considered, by the IRC.</p>
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			<p>We believe this is an area where best practices will develop.</p>
<p>Section 2.5</p>	<p><i>Responsibilities</i></p>	<p>Two industry commenters told us that the requirement for the IRC to deliberate in the absence of management was impractical and unnecessary. They suggested the IRC should be allowed to decide whether to include or exclude representatives of the manager from its proceedings. Alternatively, one of these commenters told us that Commentary 2 should clarify that the IRC can meet with representatives of the manager or any entity related to the manager to discuss any matters before the IRC.</p> <p>One commenter asked us to move the phrase “provide impartial judgement” to the Commentary, since the IRC members will be independent and their duty is to recommend what would be a “fair and reasonable result”.</p> <p>Another commenter told us that the criteria for review by the IRC of a matter referred to it should include that the proposed action by the manager is in the fund’s best interests.</p>	<p><i>CSA Response</i> <i>The IRC’s deliberations</i> Part 3 of the Proposed Rule now sets out the responsibilities of the IRC.</p> <p>Given the IRC’s focus on management decisions that involve a conflict of interest for the manager, we continue to believe that the IRC should make its decisions in the absence of any representative of the manager, or an entity related to the manager.</p> <p>However, in response to the comments, the Commentary now clearly reiterates our view that the IRC may meet with management or any person who is not considered ‘independent’ as defined in the Proposed Rule, to discuss any matter before the IRC.</p> <p><i>The IRC’s review and determination</i> Part 5 of the Proposed Rule now sets out the determination that the IRC must form in its review of conflict of interest matters.</p> <p>For the manager to proceed with certain types of prohibited transactions without regulatory approval (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters), the prior approval of the IRC must now be obtained.</p> <p>For any other proposed course of action by the manager</p>

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			<p>that involves or may be perceived to involve a conflict of interest for the manager, we continue to believe a determination of the IRC of whether the action is a fair and reasonable result for the investment fund is appropriate.</p>
	<p><i>IRC's charter</i></p>	<p>Two commenters told us the 2004 Proposal should provide guidance on the CSA's expectations as to the role, obligations and functions of the IRC, and that these responsibilities should be aligned with existing corporate governance standards for corporate boards.</p> <p>Another commenter expressed concern that the 2004 Proposal lacked specific parameters for the IRC's mandate and responsibilities. This commenter told us permitting each fund complex to set its own charter effectively grants self-regulatory powers to mutual funds, and makes a comparison of governance standards among mutual funds difficult.</p> <p>We were also told that if the concept of 'shared' IRCs remained, the Commentary should clarify that a separate charter for each fund family is necessary.</p> <p>Finally, one commenter remarked that the IRC's adoption of a written charter setting out its mandate should not be interpreted to allow an IRC to unilaterally enlarge its</p>	<p><i>CSA Response</i></p> <p>We were persuaded by the commenters who told us to set specific parameters around the IRC's mandate and responsibilities, which form the basis of the IRC's written charter.</p> <p>Accordingly, Part 3 of the Proposed Rule now sets out the functions we expect the IRC to fulfill. We consider many of the IRC's obligations under this part – regular assessments, reporting obligations, for example – to be consistent with good governance practices.</p> <p>We believe the changes made in the Proposed Rule will ensure a minimum governance standard among all investment funds subject to the instrument, and a level of uniformity in IRC charters.</p> <p>In response to comments, the Commentary to the Proposed Rule has been revised to specify that we would expect an IRC of multiple fund families to prepare a separate charter for each fund family.</p> <p>The Proposed Rule has also been revised to state that any mandate of the IRC beyond the scope of the Proposed Rule must be by mutual agreement of the IRC and the manager.</p>

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		mandate or powers beyond 2004 Proposal, without the fund manager's consent.	
Section 2.6	<i>Standard of care</i>	<p>One commenter remarked that the standard of care for IRC members should be to act in the best interests of fund securityholders, since there may be instances where a mutual fund might stand to benefit from transactions that do not directly benefit securityholders.</p> <p>Another commenter also suggested that we delete Commentary 2 as it is unnecessary.</p>	<p><i>CSA Response</i> We believe the standard of care for a member of the IRC when carrying out his or her function should be to act 'in the best interests of the investment fund'. This standard is consistent with the manager's standard of care and the standard of care expected of directors of corporate boards.</p> <p>The Commentary now describes our expectation that any consideration by the IRC of the best interests of the investment fund would, first and foremost, be a consideration of the best interests of the securityholders in the investment fund.</p>
Section 2.7	<i>Authority</i>	<p>One commenter asked us to give the IRC the authority to require indemnification by the fund manager or the fund under appropriate circumstances.</p> <p>As a technical matter, two commenters remarked that the 2004 Proposal must provide the mutual funds and the fund manager with an exemption from Part 5 of NI 81-102 (and corresponding Section 3.2 of the 2004 Proposal), for expenses related to compliance with the 2004 Proposal.</p>	<p><i>CSA Response</i> We disagree that the IRC should have the authority to require the manager or investment fund to indemnify them.</p> <p>The Proposed Rule permits an investment fund and manager to indemnify and insure the members of the IRC, consistent with the CBCA. We believe this is an area where industry practice may develop.</p> <p><i>Technical concern</i> Upon review, we do not consider the expenses incurred by the introduction of the IRC in the Proposed Rule to be caught by section 5.1 of NI 81-102.</p> <p>Our view is that the purpose of section 5.1 is not to capture the costs associated with compliance by an investment fund of new regulatory requirements.</p>

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	<p><i>Indirect compensation by the manager</i></p>	<p>While one industry commenter agreed with us that a fund manager’s direct or indirect compensation to the IRC would seriously undermine the independence of IRC members from the manager, an investor advocate told us that fund investors should not have to pay to keep managers honest; the costs of the IRC should be included in the services provided by the manager for its fees.</p> <p>Still another commenter told us that prohibiting indirect compensation by the manager to the IRC will not make the IRC more or less independent from a practical perspective.</p> <p>A large number of industry commenters remarked that preventing a manager from absorbing the costs of the IRC demonstrated our lack of understanding of how expenses are often charged to, and recovered from, mutual funds.</p> <p>These commenters explained that typically in fund companies there is a ‘pool’ of costs that are chargeable to the funds which are allocated between all of the funds managed by a manager. These costs are then added to the ‘direct’ costs charged to a fund and included in the management fee for that fund. In many cases, fund managers will absorb some expenses rather than passing them to the fund to maintain a management expense ration (“MER”) at a competitive level.</p>	<p><i>CSA Response</i></p> <p>We were persuaded by the commenters who told us to allow the manager to indirectly pay (by absorbing the costs) at least some of the costs associated with the IRC. Particularly convincing to us were the comments that discussed the effect on the MER of smaller investment funds if they are not permitted to have the manager absorb the costs of the IRC.</p> <p>We are satisfied that the provisions in the Proposed Rule that require the IRC to set its own compensation, and mandate that the IRC be 100 percent “independent”, fosters an independent-minded IRC and avoids any undue manager influence. Accordingly, the Commentary to the Proposed now specifies a manager is not prohibited from reimbursing the investment fund for the fees and expenses incurred by the IRC.</p>
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		<p>We were told that if the 2004 Proposal prevents a manager from absorbing the costs of the IRC, the MERs of mutual funds will increase and depending on the size of the fund complex, the increases may be significant and negatively impact fund performance. This, we were told, is particularly relevant for smaller funds.</p>	
	<p><i>IRC setting compensation</i></p>	<p>Commenters had differing views on whether IRC members in setting their own compensation put themselves in a conflict of interest situation. Three commenters told us yes it did, while one commenter said it did not, although suggested we clarify this in the Commentary under Section 2.4.</p> <p>We also received varied opinions on whether IRC members should set their own compensation.</p> <p>Three commenters told us the fund manager should set the IRC's compensation or have a veto power, as a 'check' on possible abuses by IRC members.</p> <p>Two other commenters suggested the IRC's compensation be set jointly by the manager and the IRC.</p> <p>Another commenter remarked that another body should approve the IRC's compensation.</p>	<p><i>CSA Response</i> <i>Conflict of interest for the IRC</i> We do not believe that the IRC setting its own compensation will interfere with the exercise of a member's independent judgment.</p> <p>The Commentary to the Proposed Rule now articulates this position.</p> <p><i>Setting its own compensation</i> We strongly believe that the IRC setting its own compensation will foster an independent-minded committee, and will avoid undue manager influence. This requirement is consistent with good governance practices, and we believe it will be an area where industry best practices develop.</p> <p>We agree, however, with those commenters who told us the manager should have a role in determining the IRC's compensation, and that the compensation set by the IRC should be disclosed.</p> <p>Accordingly, the Proposed Rule now requires that (i) in setting its compensation and expenses, the IRC must consider the manager's recommendation, and (ii) in the newly required annual report prepared by the</p>

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		<p>Alternatively, these commenters told us that if the IRC sets its own compensation, the compensation set, any rejection of the manager’s recommendation (for compensation and expenses), and the expenses incurred by the IRC for external advisers, should be subject to mandatory disclosure in the funds’ continuous disclosure documents.</p> <p>It was also suggested that the 2004 Proposal provide some guidance regarding the method by which compensation scales should be determined.</p>	<p>IRC to securityholders, the IRC must disclose any instance where the IRC, in setting its compensation and expenses, did not follow the recommendation of the manager.</p> <p>The consequential amendments accompanying the Proposed Rule set out additional prospectus disclosure requirements concerning the IRC’s compensation.</p>
Section 2.8	<i>Liability</i>	<p>Three commenters told us that the 2004 Proposal, not Commentary, must speak to the liability of members of the IRC. One of these commenters also remarked that the 2004 Proposal should provide that IRC members are protected by the “business judgment rule,” saying Section 2.6 may not provide adequate protection for a committee member.</p> <p>One commenter pointed out that the 2004 Proposal does not address manager liability. They told us it is unclear what liability the manager will incur if it follows the direction of the IRC to the detriment of the fund and investors, or how a manager’s liability will be affected if it does not follow the IRC’s direction but no harm to the fund or investor results.</p>	<p><i>CSA Response</i> <i>Liability of IRC members</i></p> <p>The Proposed Rule now specifies that the investment fund and manager may indemnify and insure members of the IRC. For greater certainty, we have used terminology consistent with the Canada Business Corporations Act (CBCA).</p> <p>The Proposed Rule now also provides greater specificity of the limits on the IRC’s mandate and its duty of care. We have been advised by external counsel hired to assist us on the issue of liability, that these drafting changes (which mirror terminology used in the CBCA, where appropriate) will sufficiently limit the liability of members of the IRC to their mandate. It also increases the likelihood of a member’s ability to invoke the common law defences available to directors.</p>

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		<p>Another commenter strongly urged us to clearly establish the responsibility and accountability of the fund manager. This commenter suggested that the current standard of care in securities legislation be moved to the beginning of Part 3.</p>	<p><i>Manager liability</i> The Proposed Rule now contains a standard of care provision for the manager, which mirrors the statutory standard of care provision for managers found in some jurisdictions.</p> <p>The inclusion of this provision in the Proposed Rule emphasizes our view that the manager is ultimately responsible, and therefore liable, for the decisions it makes on behalf of the investment funds it manages.</p> <p>This is further highlighted in now Part 5 of the Proposed Rule which specifies that prior to referring a matter to the IRC, the manager must first decide on the action it proposes to take, having regard to its duties under securities legislation.</p> <p>The Commentary to Part 5 of the Proposed Rule further states our position that a referral by the manager to the IRC of a proposed action in no way detracts from the manager’s statutory obligations.</p>
	<p><i>Insurance coverage for IRC negligence</i></p>	<p>A large number of industry commenters told us we must clarify if Commentary 2 is meant to exclude insurance coverage for an IRC member’s negligence. These commenters submitted a mutual fund should be permitted to purchase coverage for a breach of a standard of care, as permitted under the CBCA. We were told that in the absence of proficiency requirements and ongoing education standards, negligence and breach of standard of care are of concern.</p>	<p><i>CSA Response</i> As noted above, the Proposed Rule has been revised to permit an investment fund and/or the manager to indemnify and insure members of the IRC.</p> <p>We were persuaded by those commenters who told us we should permit insurance coverage of IRC members in a manner consistent with similar provisions in the CBCA. We have made this change.</p>

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		<p>While one commenter remarked that if Director & Officer (“D&O”) insurance does not cover negligence, they saw no benefit to insurance, another commenter acknowledged that Commentary 2 is consistent with the OBCA.</p> <p>As an alternative to funds indemnifying or insuring IRC members for negligence, one commenter urged us to permit fund managers to purchase such insurance.</p>	
Section 2.9	<i>Proceedings</i>	<p>One commenter told us that the 2004 Proposal should require the IRC’s records to be available to investors upon request.</p> <p>Another commenter remarked that where an IRC is shared with another fund manager or managers, the maintenance of records may be problematic and cumbersome.</p>	<p><i>CSA Response</i> The Proposed Rule does not require the IRC’s records to be made available to securityholders upon request. We believe this is consistent with governance practices of corporate boards.</p> <p>While we agree with the commenter who told us that recordkeeping may be troublesome where an IRC is shared with another manager or investment fund complex, we still believe it is feasible for managers to share an IRC.</p>
Section 2.10	<i>Ceasing to be a member</i>	<p>While one commenter sought assurance that all individuals will cease to be members of an IRC in instances of a change of control of the manager, in addition to a change of manager, another commenter told us not to mandate a change of all IRC members in these circumstances.</p> <p>This commenter remarked that changing the IRC in such instances does not benefit</p>	<p><i>CSA Response</i> We agree with the commenter who told us that a change of control of the manager should cause individuals to cease to be members of an IRC. We have made this change.</p> <p>We continue to believe that a new manager should have the opportunity to appoint the first members of the fund’s IRC, having regard to the investment objectives and strategies it is proposing for the investment fund.</p>

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	<p>investors because there is a lack of continuity, a new period where IRC members, appointed by manager, are not fully independent, and there are costs in educating new members. It was suggested that the 2004 Proposal require that on a change of manager or change of control of manager, that one-third of members of the new IRC be from the existing IRC.</p> <p>We also received comments on other factors that should warrant the removal of an IRC member in the 2004 Proposal.</p> <p>One commenter told us a manager should have the ability to remove an IRC member if the individual moves outside of the jurisdiction where the manager is located. Another remarked that IRC members should cease to be members if subject to regulatory or criminal sanctions.</p> <p>We were also told that an IRC member should not be able to sit as a member of an IRC of another fund complex, and should cease to be a member of an IRC if they join the board of directors of, or advisory committee to, another mutual fund manager or if they become a member of another IRC.</p> <p>One commenter remarked that the 2004 Proposal must provide the manager, as a last measure, some method for identifying and resolving situations of inappropriate and potentially harmful actions of IRC members.</p>	<p><i>Other factors warranting removal from the IRC</i> Upon review of the circumstances suggested by commenters warranting a member's removal from an IRC, we agree with the commenter who told us an individual should cease to be a member of the IRC if subject to regulatory or criminal sanctions. We have amended the Proposed Rule accordingly.</p> <p>We disagree, however, that removal of an IRC member, if the member moves outside the jurisdiction of the manager or if the member participates on a board or IRC of another manager, must be mandated in the Proposed Rule. We consider the members of the IRC to be best-positioned to assess a member's ability to perform his or her function.</p> <p>We are satisfied that the Proposed Rule gives IRC members, and the manager, sufficient recourse to remove a member of the IRC who is no longer independent within the definition in the Proposed Rule.</p>
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		<p>Another commenter echoed this, asking that we provide additional guidance in the Commentary for special meetings called by the manager to remove a member of an IRC.</p> <p>We were also told by a commenter to remember that there is considerable time and expense associated with the procedural remedy contemplated in paragraph 2.10(2)(b).</p> <p>Finally, we were asked by a commenter to clarify why regulators want to be informed of a mass resignation and what we would do with this information.</p>	<p><i>The requirement to inform the regulator</i> We believe that the resignation, removal and disqualification of one or more IRC members may be an early warning sign of a larger, more systemic problem with the IRC or manager. Upon receipt and review of such information, our intention is to determine if further follow-up with the IRC or manager is warranted.</p> <p>We consider this approach to be consistent with the CSA's increasing emphasis on continuous disclosure and compliance reviews.</p>
Section 2.11	<i>Disclosure not enough</i>	<p>We heard from a number of commenters on the 2004 Proposal's proposition that disclosure is an effective deterrent for managers to follow an IRC's recommendation.</p>	<p><i>CSA Response</i> <i>The IRC's lack of 'teeth'</i> We were persuaded by those commenters who told us that disclosure of a manager's noncompliance with an IRC recommendation should be more forthright, and that recommendations do not give the IRC the "teeth" needed to act as an effective investor protection</p>

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		<p>Investor commenters unanimously told us that disclosure of a manager’s noncompliance with an IRC’s recommendation is not an effective remedy or sufficient for robust investor protection. We were told that the disclosure will probably come too late and may not be specific enough. These commenters also said few investors will likely be aware of it, because of exemptive orders and proposed rules which contemplate many disclosure documents only upon request, and the size of current mutual fund prospectuses.</p> <p>Still another commenter, an independent board of a mutual fund, said they viewed the IRC as having “very little power” and “teeth” and not in the best interests of securityholders. It was suggested that the IRC be required to report on its activities on an annual basis to securityholders.</p> <p>Two industry commenters similarly told us that we must strengthen the remedy to securityholders when the manager does not follow an IRC’s recommendation. One of these commenters suggested the 2004 Proposal require notice to securityholders, and a 30 day period after notice to redeem without charge (with no back-end load payment) if the IRC considers it warranted.</p> <p>Other suggestions we received to strengthen</p>	<p>mechanism.</p> <p>Accordingly, the Proposed Rule now requires that the manager obtain the approval of the IRC before proceeding with certain types of prohibited transactions (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters) that would otherwise require the approval of the securities regulatory authorities or regulators.</p> <p>For all other proposed actions by the manager that involve a conflict of interest or a perceived conflict of interest for the manager (and which continue to be subject to an IRC recommendation), the Proposed Rule now gives the IRC the discretion to require the manager to give immediate notice to securityholders of its decision to proceed despite a negative recommendation of the IRC.</p> <p>In response to comments, the Proposed Rule now also requires the IRC to prepare a report directed to securityholders at least annually. The report must disclose any instance where the manager proceeded to act without the positive recommendation of the IRC.</p> <p>Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC to report instances where it finds (or has reasonable grounds to suspect) breaches of the matters under its review.</p>
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		<p>the IRC’s recommendations were:</p> <ol style="list-style-type: none"> 1. to give the IRC the power to remove a manager, 2. to allow the IRC to meet separately with regulators or law enforcement, and 3. to have the IRC report directly to fund securityholders at regularly scheduled securityholder meetings to enable securityholders to question management (and the IRC). 	<p><i>Specific suggestions to ‘strengthen’ the IRC</i></p> <p>Except for the suggestion by one commenter to give the IRC the authority to remove the manager, we consider that the Proposed Rule captures the substance of the suggestions we received to improve the ‘teeth’ of an IRC recommendation. Namely, the ability of the IRC to directly communicate with securityholders and with the regulator.</p> <p>Our view is that the manager is fundamental to the investor’s ‘commercial bargain’ with the investment fund, and accordingly, the IRC should not be able to remove the manager.</p>
	<p><i>Comments on the disclosure required</i></p>	<p>We also received a number of comments on what should be disclosed to investors and where.</p> <p>One commenter told us the disclosure contemplated in the 2004 Proposal could result in too much information being sent to investors, which will be confusing as well as costly and unproductive.</p> <p>Another commenter told us to delete the section entirely and move disclosure requirements to the amendments to NI 81-101 and NI 81-106.</p> <p>We were told by two commenters to</p>	<p><i>CSA Response</i></p> <p>The consequential amendments accompanying the Proposed Rule now set out the disclosure we expect in the prospectus and continuous disclosure documents of the investment fund regarding the IRC.</p> <p>In response to the comments, care has been taken to avoid duplicative disclosure requirements.</p> <p>Contrary to the views of a few commenters, we consider every instance where the manager proceeds to act without the IRC’s positive recommendation to warrant disclosure.</p> <p>Accordingly, the Proposed Rule requires that the annual report to be prepared by the IRC disclose any instance where the manager proceeded to act despite a</p>

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		<p>introduce a ‘materiality’ threshold to disclosure of instances where the manager did not follow the IRC’s recommendation. One of these commenters further remarked that this materiality test should apply to all continuous disclosure regarding the IRC, noting that disclosure otherwise will be repetitive and become boilerplate and meaningless.</p> <p>One commenter asked that the requirement on the manager to disclose a report by the IRC if so directed by the IRC, be removed.</p> <p>We were also asked to not require duplicative disclosure in a fund’s prospectus and continuous disclosure documents.</p> <p>Finally, a commenter asked us to clarify that when IRC members change, it will not trigger an amendment to all fund prospectuses. They suggested that updated lists could be included on the websites of the manager and required in subsequent filing of prospectus.</p>	<p>negative recommendation from the IRC. To avoid the concern of ‘boiler plate’ disclosure raised by a commenter, the Proposed Rule specifies only the minimum topics we believe the report must include.</p> <p>To address the concerns raised by commenters regarding the amount and cost of the disclosure contemplated, the Proposed Rule specifies that the IRC report be filed with the securities regulatory authorities or regulator, posted on the website of the investment fund/fund family/manager, and be available on request by the investor without cost.</p>
Part 3			
Section 3.1	<i>Conflicts of interest</i>		
	<i>The test</i>	<p>Almost every commenter expressed an opinion on the test and scope of Section 3.1.</p> <p>While one commenter told us our principles-based definition of conflicts of interest was a realistic way to address the range of conflicts</p>	<p><i>CSA Response</i></p> <p>The purpose of the Proposed Rule is to ensure an independent perspective is brought to bear on the transactions and operations of an investment fund that have an inherent conflict of interest for the manager.</p> <p>We consider the principles-based definition of a</p>

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		<p>that are inherent in the manager-mutual fund relationship, another commenter remarked that Section 3.1 is too broad and ambiguous, and will be open to different interpretations.</p> <p>Still another commenter expressed concern that over time, the role of IRC will expand into matters that should be left to the manager.</p> <p><i>Limits to the ‘principles’ based test</i> A number of industry commenters strongly urged us to revise the test to contain a defined, but comprehensive, list of specific conflict referrals, in addition to the conflict of interest prohibitions in securities legislation.</p> <p>Yet other commenters told us to allow the IRC and fund manager define “conflicts of interest” in the IRC’s charter.</p> <p>Two commenters suggested we combine subsections 3.1(1) and (2) to create a simpler test, which introduces the concept of materiality; that is, only material interests or conflicts should be referred to the IRC. We were also told to be consistent with MI 52-110.</p> <p>It was also suggested by a commenter to permit a de minimis test for referral to the IRC in non-recurring situations in which there is a direct conflict, but where the potential cost and risk to the fund is small.</p>	<p>‘conflict of interest matter’ in the Proposed Rule to best capture the range of possible management decisions that may involve a conflict of interest for the manager.</p> <p>We would expect that any proposed course of action a manager considers to involve a conflict of interest, would similarly be caught by the test in the Proposed Rule.</p> <p>We continue to believe that the manager (and ultimately the investment fund and securityholders) could benefit from the independent perspective and input of an IRC on all decisions that may involve a conflict of interest for the manager. Therefore, none of the limitations suggested by commenters to the scope of the conflicts of interest caught by the 2004 Proposal have been adopted in the Proposed Rule.</p>
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		<p>Commenters also asked us to define what is meant by the word “matter”. We were told that matters should not include business decisions but situations where true conflicts of interest could arise. Examples: allocating securities amongst mutual funds in a family and other clients, seeking best execution, and entering into soft dollar arrangements.</p> <p>Still another commenter remarked that if the CSA’s intention is that all matters in Commentary 5 (related-party conflicts) be referable to the IRC, for certainty, Commentary 5 should be moved to the 2004 Proposal.</p> <p>One commenter remarked that the manager should retain the ability to refer any matter to the IRC that it views as a conflict of interest.</p> <p><i>The need to specify each step</i> We were told by three industry commenters that the 2004 Proposal should specify the specific steps expected of the fund manager when faced with a conflict of interest matter.</p> <p>A number of others also asked us to have the test specify that the IRC may approve the policies of the manager in advance, and that this will discharge the manager’s duty under Section 3.1, provided there is regular reporting for the IRC to satisfy itself that the fund manager is in compliance with its policies and procedures.</p>	<p><i>The need to specify each step</i> We were persuaded by the commenters who told us to specify the steps expected of the manager and IRC when an action under consideration by the manager involves a conflict of interest. Accordingly, the Proposed Rule now sets out the procedure that the manager and IRC must follow in these circumstances.</p> <p>In response to the comments, the Proposed Rule now requires the manager to refer a proposed course of action to the IRC before proceeding to act, after having considered the action in regard to its duties under</p>
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	<p>Still other commenters remarked that the 2004 Proposal should require that the IRC review and approve in advance the policies relating to related party transactions.</p> <p><i>Independent auditor testing</i> While one commenter told us independent auditors should be required to pass opinion on the internal policies and procedures or controls of the manager, another commenter suggested that the IRC be given the ability to investigate and test for potential areas of conflict, using an external auditor if desired.</p> <p><i>Specific wording in the test</i> One commenter asked us to consider replacing “question whether” with ‘consider’ in subsection 3.1(1), because the plain meaning of the wording suggests referrals to the IRC will only occur when there is uncertainty whether the fund manager is in a conflict situation.</p> <p>Three other commenters asked us to delete “different from” in subsection 3.1(2) because, they told us, many normal day-to-day business operations of the mutual fund appear to be caught by “different from”. These commenters remarked that only a situation in which a manager has an interest that</p>	<p>applicable laws and its written policies and procedures. The IRC must then review the action and make the applicable determination. If the IRC so chooses, it may give a standing instruction to the manager for an action or category of actions, subject to its ongoing oversight.</p> <p>Further, for any matter the manager must refer to the IRC, the manager must have established written policies and procedures, with IRC input, before proceeding to act on the matter.</p> <p><i>Independent auditor testing</i> We disagree with the commenters who told us that the 2004 Proposal should mandate an independent audit of the manager’s policies and procedures or controls.</p> <p>The Proposed Rule authorizes the IRC to employ independent counsel and other advisers it determines useful or necessary to carry out its role. We continue to believe a flexible approach to the IRC’s use of external advisers is desirable.</p> <p><i>Specific wording in the test</i> The definition of a ‘conflict of interest matter’ in now Section 1.3 of the Proposed Rule was drafted with the wording suggestions of commenters in mind.</p>
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		<p>“conflicts with” the best interests of the fund should be referred to the IRC.</p> <p><i>Portfolio manager conflicts</i> We were asked by a number of commenters to clarify in the 2004 Proposal how Section 3.1 applies to potential conflicts at a portfolio manager level, particularly when outsourced. It was suggested that either:</p> <ol style="list-style-type: none"> 1. the IRC have no role if the manager has discharged day-to-day decision making to an unrelated third party adviser, or 2. the Section should clarify that either that the fund manager has no obligation to monitor portfolio manager conflicts (especially unrelated portfolio managers), or, the fund manager must make reasonable inquiries of the portfolio managers of their policies and procedures to deal with any conflicts falling within a defined list. <p><i>Non-referrals of matters</i> We heard from both industry and investor commenters that the 2004 Proposal fails to provide a monitoring process, or penalty, for non-referral of matters, to ensure management upholds its obligations to refer conflicts to the IRC. These commenters also told us there is no guidance on what the IRC should do, if anything, if the fund manager refers very little to it for its review and consideration.</p>	<p><i>Portfolio manager conflicts</i> The Proposed Rule is intended to capture the conflicts of interest at the manager and portfolio manager level that may conflict with the manager’s duty to act in the best interests of the fund.</p> <p>For greater certainty, the definition of a ‘conflict of interest matter’ in the Proposed Rule specifies that any proposed action that is related to the operations of the investment fund that the manager, investment fund or portfolio manager is prohibited from proceeding with by a conflict of interest or self-dealing prohibition in securities legislation, is considered a ‘conflict of interest matter’ under this instrument (which must be referred to the IRC).</p> <p><i>Non-referrals of matters</i> We were persuaded by the commenters who expressed concern over how referrals to the IRC of conflict of interest matters would be ensured and enforced.</p> <p>As a result, the Proposed Rule now gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC, on matters within the scope of its responsibility,</p>
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			<p>to report a breach, or a reasonable suspicion of a breach, of securities legislation.</p> <p>We consider these mechanisms to give the IRC sufficient recourse if it suspects non-referral of conflict of interest matters.</p>
	<p><i>Conflicts</i></p>	<p>Almost all industry commenters told us that the definition of “conflicts of interest” is too broad. Specifically, we were told that the description of “business conflicts” seems to catch almost all business decisions, and the Commentary’s “prescriptive, non-exhaustive list of potential conflicts” creates uncertainty, and that they disagree with many of the conflict matters listed in the Commentary.</p> <p>We were told that in instances where the fund manager is either related to or acts as the portfolio manager, back office service provider and trustee, it is possible that every service provided by the fund manager to the fund would fall under the scope of the IRC’s review.</p> <p>One commenter suggested that the IRC’s mandate to monitor all administration and management of the mutual funds risks creating a material relationship between the IRC and the manager.</p> <p>Three commenters questioned why marketing is considered a conflict in light of National Instrument 81-105 <i>Mutual Fund Sales</i></p>	<p><i>CSA Response</i></p> <p>We disagree with those commenters who expressed alarm at the broad definition of ‘conflicts of interest’ in the 2004 Proposal. The inherent, and often numerous, conflicts of interest that could arise in the management of an investment fund are precisely the matters we believe should be subject to the independent review and input of the IRC.</p> <p>We do not consider, as one commenter suggested, that the IRC’s role in the operations of the investment fund would impede a member’s ability to exercise independent judgment regarding the conflicts of interest facing the manager.</p> <p>We were, however, persuaded by those commenters who told us that the lists of potential conflicts in the Commentary to the 2004 Proposal creates uncertainty and serves to undermine the principles-based approach to a manager’s ‘conflicts of interest’.</p> <p>Accordingly, the non-exhaustive list of possible conflicts of interest in the Commentary has been removed in the Proposed Rule. As a result, we would expect the specific conflict examples raised by commenters to be looked at on a case-by-case basis.</p>

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		<p><i>Practices</i> (“NI 81-105”). One of these commenters remarked that the IRC should not assume a compliance/enforcement role with respect to specific rules or policies already in place.</p> <p>Other specific ‘conflicts’ we were told should be excluded from the scope of IRC review were:</p> <ol style="list-style-type: none"> 1. conflicts with third-party oversight, such as with fund auditors. 2. fee changes, since fees are disclosed in the prospectus and part of consensual commercial bargain, and 3. the appointment of the manager of an affiliate as an adviser to the fund <p>Yet, we were also asked by one commenter why the personal trading policies of the fund manager were not referenced in the list of business conflicts in the Commentary.</p> <p>This commenter also recommended that the listed potential conflict “Favouring certain investors to obtain or maintain their investment in the mutual fund” be expanded to better describe the CSA’s intentions.</p>	
	<p><i>Conflict Prohibitions in Securities Legislation</i></p>	<p>One commenter questioned the CSA’s intentions for dealing with the overlap of the conflict of interest prohibitions in the Ontario Act (and other applicable provincial statutes), since the Uniform Securities Legislation does</p>	<p><i>CSA Response</i> The Proposed Rule and accompanying consequential amendments to NI 81-102 specifically exempt investment funds from the statutory prohibitions that prevent those conflict of interest transactions that, we consider, can be addressed through IRC review and</p>

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		<p>not contain any part similar to Part XXI of the Ontario Act.</p> <p>This commenter recommended that we provide clear commentary about any decision to exempt mutual funds and their managers from the conflict of interest provisions in securities legislation to the extent they comply with the 2004 Proposal. We were also told the Commentary should be clear that the IRC is meant to reinforce the duty on the fund manager to act in the best interest of the fund, and that the manager must still abide by duty of care.</p>	<p>approval.</p> <p>The Notice to this Instrument and the Proposed Rule specify our intention that all prior exemptions granted from the conflict of interest and self-dealing provisions in securities legislation may no longer be relied on following the transition date.</p> <p>We continue to monitor the progress of the Uniform Securities Legislation. As it progresses, we expect to re-visit the conflict of interest prohibitions contained in our respective legislation and consider what prohibitions should be incorporated into rules governing investment funds.</p>
Section 3.2	<i>Changes to the mutual fund</i>	<p>One commenter, who told us IRC review will impose a longer time frame than currently to implement a change, asked that we shorten the notice period.</p>	<p><i>CSA Response</i></p> <p>We do not propose within the scope of this project to review the 60 day notice requirement in Part 5 of NI 81-102. This may be an area that requires revisiting after we gain some experience with IRC reviews of matters under Part 5 of NI 81-102.</p>
Section 3.4	<i>Supporting information</i>	<p>We were told by a commenter that the authority of the IRC to direct the manager to convene a special meeting of securityholders to consider and vote ‘on a matter’ is unnecessary, unrealistic and too open for misuse. This commenter remarked it is not clear what securityholders would be voting on, and in circumstances where the IRC believes that the fund manager has breached or will breach its fiduciary standards, an IRC would more realistically follow different avenues, including resignation, public</p>	<p><i>CSA Response</i></p> <p><i>IRC ability to compel a meeting</i></p> <p>We were persuaded by those commenters who told us the authority of the IRC to direct the manager to convene a securityholder meeting is not an effective response if the IRC is concerned the manager is not acting appropriately.</p> <p>Accordingly, the Proposed Rule no longer gives the IRC the authority to direct the manager to convene a meeting of securityholders.</p> <p>Instead, in instances where a manager intends to proceed with a course of action without a positive</p>

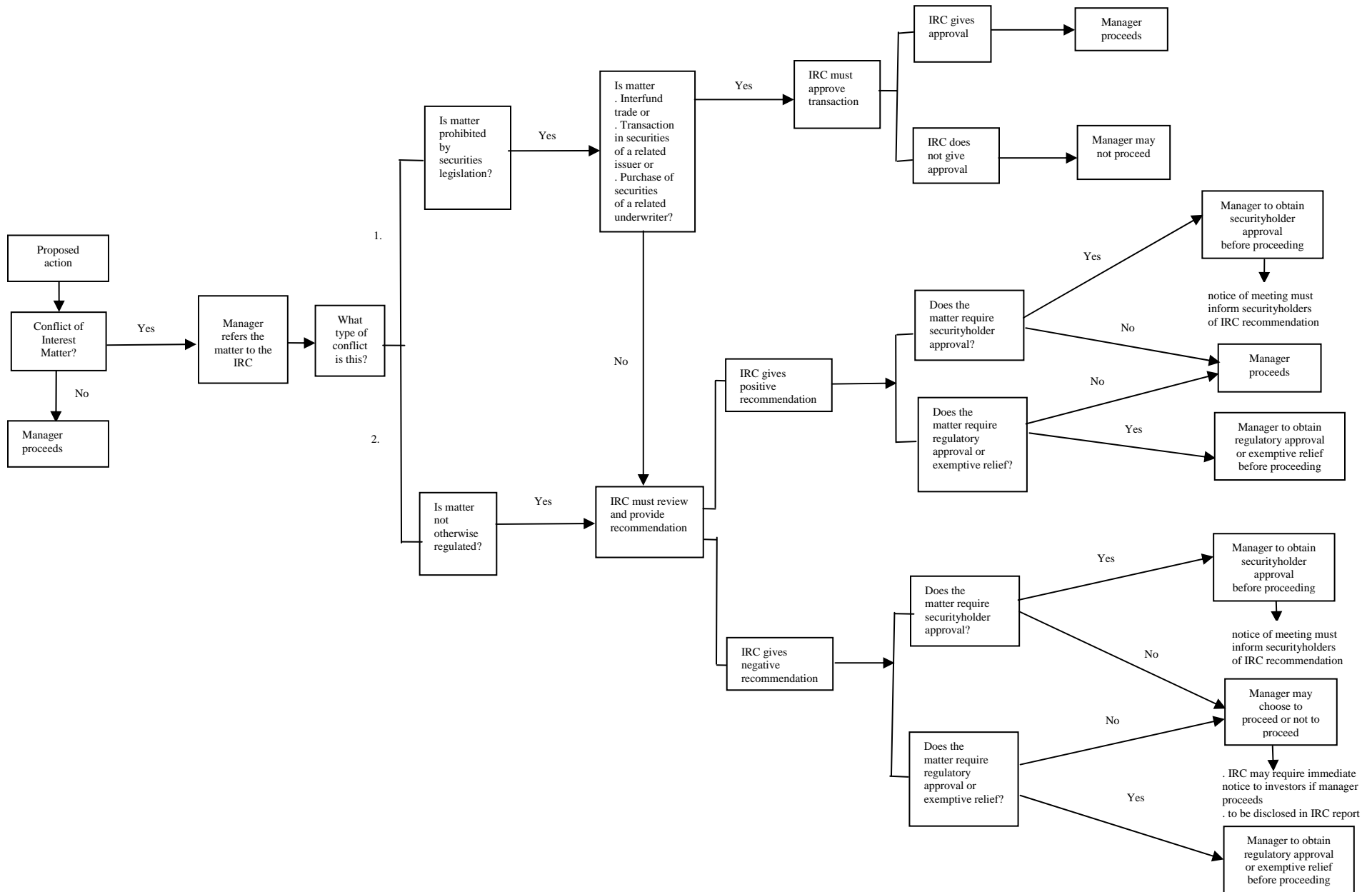
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		<p>disclosure or contacting the applicable securities regulatory authorities.</p> <p>This commenter went on to say that the disclosure contemplated in section 2.11 is more effective than the IRC convening a meeting of securityholders, because it requires the fund manager to publicly explain why it did not follow the recommendation, as contemplated by the Rule.</p> <p>Two commenters also remarked that the 2004 Proposal provides no checks and balances or element of materiality on an IRC convening a meeting. They warned that the IRC could use the power to convene a meeting in a manner not contemplated by the CSA, and suggested the IRC be given guidance to consider the costs of holding such a meeting.</p> <p>It was also remarked that the Commentary is unclear if the IRC should rely on NI 54-101 <i>Communication with Beneficial Owners of Securities of a Reporting Issuer</i> in communications with securityholders or if the IRC has authority to independently contact securityholders.</p>	<p>recommendation by the IRC, the IRC now may, in its discretion, require the manager to notify securityholders at least 30 days before proceeding with the action.</p> <p>Notice of a manager proceeding without a positive recommendation of the IRC must also be reported by the IRC in its report to securityholders, to be prepared at least annually.</p> <p>In addition to notifying securityholders, the Proposed Rule now gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC, on matters within the scope of its responsibility, to report a breach, or a reasonable suspicion of a breach, of securities legislation.</p>
<p>Section 4.1 Section 4.2</p>	<p><i>Exemptions</i> <i>Revocations of exemptions,</i> <i>waivers or approvals</i></p>	<p>One commenter questioned our authority and ability of individual commissions to revoke individual orders granted by a securities commission or director, without individual notice to the recipient and a hearing. It was queried what exemption orders existed</p>	<p><i>CSA Responses</i></p> <p>We are satisfied that we have the authority to notify, through the rule-making process, our intention to revoke orders that deal with the matters to be regulated by the Proposed Rule.</p> <p>While many orders caught by our revocation contained</p>

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

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Appendix B
Decision Tree



APPENDIX C

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

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

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

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

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

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

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

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

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

“(3.1) Under “Operating Expenses” in the table, include a description of the fees and expenses payable in connection with the independent review committee.”

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

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

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

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

“(2.1) If the mutual fund has relied on the approval of the independent review committee and the relevant requirements of NI 81-107 to be exempted from any of the investment restrictions contained in securities

legislation, including NI 81-102, provide details of the permitted exemptions.

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

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

“(a) the mandate and responsibilities of the independent review committee and the reasons for any change in the composition of the independent review committee since the date of the annual information form was last filed;

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

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

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

5. This Instrument comes into force on [].

**APPENDIX D
NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS
AMENDMENT INSTRUMENT**

1. National Instrument 81-102 Mutual Funds is amended by this Instrument.

2. Section 1.1 is amended by:

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

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

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

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

(a) prohibit a mutual fund from knowingly making or holding an investment in any person or company who is a substantial security holder, as defined in securities legislation, of the mutual fund, its management company or distribution company;

(b) prohibit a mutual fund from knowingly making or holding an investment in any person or company in which the mutual fund, alone or together with one or more related mutual funds, is a substantial security holder, as defined in securities legislation;

(c) prohibit a mutual fund from knowingly making or holding an investment in an issuer in which any person or company who is a substantial security holder of the mutual fund, its management company or distribution company, has a significant interest, as defined in securities legislation;

(d) prohibit a portfolio adviser or a registered person acting under a management contract from knowingly causing any investment portfolio managed by it to invest in, or prohibit a mutual fund from investing in, any issuer in which a responsible person or an associate of a responsible person, as defined in securities legislation, is an officer or director unless the specific fact is disclosed to the client and the written consent of the client to the investment is obtained before the purchase;

(e) prohibit a portfolio adviser knowingly causing any investment portfolio managed by it to purchase or sell, or prohibit a mutual fund to purchase or sell, the securities of any issuer from or to the account of a responsible person, as defined in securities legislation, an associate of a responsible person or the portfolio adviser; and

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

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

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

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

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

(a) the independent review committee has approved the transaction under subsection 5.2(1) of NI 81-107;

(b) for an investment in a class of equity securities of an issuer

(i) the distribution of the class of equity securities is made by prospectus filed with one or more securities regulatory authorities or regulators in Canada, and

(ii) the investment is made on a stock exchange on which the class of equity securities of the issuer are listed and traded;

(c) for an investment in a class of debt securities of an issuer other than a class of debt securities issued or fully and unconditionally guaranteed by the government of Canada or the government of a jurisdiction

(i) neither the manager of the dealer managed mutual fund nor its associates or affiliates is

(A) the issuer of the securities, or

(B) a promoter of the issuer of the securities, and

(ii) the security has been given, and continues to have, an approved rating by an approved credit rating organization; and

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

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

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

(a) the independent review committee has approved the transaction under subsection 5.2(1) of NI 81-107;

(b) for a purchase or sale of a class of debt securities of an issuer other than a class of debt securities issued or fully and unconditionally guaranteed by the government of Canada or the government of a jurisdiction

(i) neither the manager of the dealer managed mutual fund nor its associates or affiliates is

(A) the issuer of the securities, or

(B) a promoter of the issuer of the securities; and

(ii) the security has been given, and continues to have, an approved credit rating by an approved credit rating organization; and

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

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

6. Section 5.3 is amended

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

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

- (a) the independent review committee has approved the reorganization or transfer of assets under subsection 5.2(1) of NI 81-107;
- (b) the mutual fund is being reorganized with, or its assets are being transferred to, another mutual fund to which this Instrument and NI 81-107 applies and that is managed by the manager, or an affiliate of the manager, of the mutual fund;
- (c) the reorganization or transfer of assets of the mutual fund will comply with the criteria in section 5.6;
- (d) the simplified prospectus of the mutual fund discloses that, although the approval of securityholders may not be obtained before making the change, securityholders will be sent a written notice at least 60 days before the effective date of the change; and
- (e) the notice referred to in paragraph (d) is actually sent 60 days before the effective date of the change.”; and

- (b) by adding the following after section 5.3:

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

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

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

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

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

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

1. Companion Policy 81-102CP Mutual Funds is amended by this Instrument.
2. Part 3 is amended

(a) by adding the following paragraph under section 3.4:

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

(b) by adding the following after section 3.7:

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

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

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

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

“7.5 Circumstances in Which Approval of Securityholders Not Required – (1)

Subsection 5.3(2) of the Instrument provides that the mutual fund's reorganization with, or transfer of assets to another mutual fund to which this Instrument and NI 81-107 applies and is managed by the manager or an affiliate of the manager of the mutual fund, may be carried out on the conditions described in the subsection without prior approval of the securityholders of the mutual fund.

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

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

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

4. This Instrument comes into force on [].

APPENDIX E

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

1. National Instrument 81-106 Investment Fund Continuous Disclosure is amended by this Instrument.
2. Section 1.1 is amended by
 - (a) adding the following after the definition of “EVCC”:

“independent review committee” means the independent review committee of the investment fund in compliance with National Instrument 81-107 *Independent Review Committee for Investment Funds*;”;
 - (b) adding the following after the definition of “National Instrument 51-102”:

“National Instrument 81-107” means National Instrument 81-107 *Independent Review Committee for Investment Funds*;”.
3. Section 9.4 is amended by deleting paragraph (2)(f) and substituting the following:

“(f) Item 15 of Form 81-101F2 does not apply to an investment fund that is a corporation, except for the disclosure in connection with the independent review committee; and”.
4. Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance is amended
 - (a) in section 2.4 by adding the following after paragraph (e):

“(f) changes to the composition or members of the independent review committee of the investment fund. ”; and
 - (b) in section 2.5 by adding the following Instruction after Instruction (3):

“(4) *If the investment fund has an independent review committee, state whether the investment fund has relied on the positive recommendation or approval of the independent review committee to proceed with the*

transaction, and provide details of any conditions or parameters surrounding the transaction imposed by the independent review committee in its positive recommendation or approval.

5. This Instrument comes into force on [].

APPENDIX F

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

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

APPENDIX G

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

1. National Instrument 44-101 Short Form Prospectus Distributions is amended by this Instrument.
2. Section 1.1 is amended

- (a) by adding the following after the definition of “income from continuing operations”:

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

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

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

3. Form 44-101F3 Short Form Prospectus is amended by adding the following after Item 21:

“Item 22 – Independent Review Committee

22.1 – Independent Review Committee

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

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

committee, including the names of the members, is available in the investment fund's annual information form; and

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

4. This Instrument comes into force on [].

**APPENDIX H
NATIONAL INSTRUMENT 81-104
COMMODITY POOLS
AMENDMENT INSTRUMENT**

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

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

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



Document Type: Rule
Document N°: 81-107
Subject: Independent Review Committee for Investment Funds
Amendments:
Published Date: ■
Effective Date: ■

Proposed National Instrument 81-107

Independent Review Committee for Investment Funds

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Introduction

This National Instrument (the Instrument) is designed to improve the governance standards of investment funds. The Canadian securities regulatory authorities (the CSA) believe the Instrument will promote protection of investors in investment funds while fostering market efficiency. The Instrument introduces the requirement for an independent governance body (the independent review committee or IRC) for all publicly offered investment funds. The IRC is charged with reviewing conflicts of interest that may arise between a manager's own interests and the manager's duty to manage an investment fund in the best interests of the investment fund.

The Instrument requires there to be an independent perspective on all of the manager's decisions that may involve or be perceived to involve a conflict of interest, not just the prohibitions relating to related-party and self-dealing transactions currently restricted or prohibited in securities legislation.

For certain prohibited conflict of interest matters, the Instrument relieves an investment fund from seeking regulatory approval, provided the IRC has reviewed and given its approval before the manager proceeds to act on the matter, and subject to certain other conditions.

This document contains both rules and commentary on those rules. Each securities administrator in Canada has made these rules under authority granted by the securities legislation of its jurisdiction. The Instrument has been adopted as a rule in each of Alberta, British Columbia, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario and New Brunswick, as a commission regulation in Saskatchewan, as a regulation in Québec, and as a policy in the remaining jurisdictions represented by the CSA. Each securities administrator has also adopted the commentary on the rules as policies. 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 is labelled as such and it always appears in italic type.

Part 1 Definitions and application

1.1 Definitions

Terms defined elsewhere in securities legislation have the meaning given to them in those instruments.

1.2 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 (commonly referred to as pooled funds) that sell securities to the public only under capital raising exemptions in securities legislation (and, therefore, are not reporting issuers).*

1.3 Meaning of “conflict of interest matter”

- (1) In this Instrument, “a conflict of interest matter” means a matter in respect of which a reasonable person would consider the 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.

- (2) In this section, any proposed course of action that an investment fund, a manager or an entity related to the manager is restricted or prohibited from proceeding with by a conflict of interest or self-dealing provision contained in securities legislation, is a “conflict of interest matter”.

Commentary

1. *Subsection (1) is intended to capture, through the term “entity related to the manager”, the conflicts of interest faced by the portfolio manager or portfolio adviser which relate to their decisions on behalf of the investment fund, that may impact the manager’s ability to act in good faith and in the best interests of the investment fund.*
2. *For greater certainty, subsection (2) specifies that any course of action which the investment fund, 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, is a “conflict of interest matter”. The CSA consider conflict of interest matters in subsection (2) to include the types of transactions described under subsection 5.2(1) that may be exempted under Part 6 of this Instrument and under Part 4 of National Instrument 81-102 Mutual Funds, provided there is IRC approval. These transactions are: inter-fund trades, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters.*
3. *This Instrument requires under section 5.1 that all conflict of interest matters defined under this section be referred by the manager to the IRC.*

1.4 Meaning of “entity related to the manager”

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

- (a) a person or company who can direct or cause the direction of the management and policies of the manager or the investment fund, whether through ownership of voting securities or otherwise, other than as a member of the independent review committee; or
- (b) an agent, 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 the portfolio manager or portfolio adviser (or sub-adviser) of the investment fund to be an “agent” for the purposes of paragraph (b).*

1.5 Meaning 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, in the opinion of a reasonable person, interfere with the member’s judgment regarding a conflict of interest matter.

Commentary

1. *Under subsection 3.5(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 that the members will 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 conflict of interest within the meaning of this definition.

3. *A material relationship referred to in subsection 1.5(1) may include ownership, commercial, charitable, industrial, banking, consulting, legal, accounting or familial relationships. The CSA expect managers and IRC members to consider both past and current relationships when determining whether a direct or indirect material relationship exists.*

For example, depending on the circumstances, the following individuals may be independent under section 1.5:

- *individuals appointed as trustees for an investment fund,*
- *members of an existing advisory board or IRC of an investment fund,*

- *members of the board of directors, or of a special committee of the board of directors, of an investment fund, and*
- *members 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, depending on the circumstances, the CSA consider it unlikely that the following individuals will be independent under section 1.5:

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

The CSA also consider it unlikely that the members of a manager’s board of directors, or special committee of the board of directors, could be ‘independent’ within the meaning of this Instrument.

1.6 Meaning of “inter-fund self-dealing investment prohibitions”

In this Instrument, “inter-fund self-dealing investment prohibitions” means the provisions of securities legislation that

- (a) prohibit a portfolio manager from knowingly causing any investment portfolio managed by it to purchase or sell, or
- (b) prohibit 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.

Commentary

1. *The term “inter-fund self-dealing investment prohibitions” is intended to capture the prohibitions contained in the securities act of each securities administrator regarding inter-fund trades.*

1.7 Meaning 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 term “manager” is intended to include instances where a corporate board or limited partnership of an investment fund acts in the capacity of*

“manager”/decision-maker, or when the circumstances of the investment fund merit the designation of more than one person or company as “manager”.

Part 2 Functions of the manager

2.1 Manager standard of care

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

- (a) must act honestly and in good faith, and in the best interests of the investment fund; and
- (b) owes a duty to the investment fund to 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 to act on 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 to be followed by it on the matter; and
 - (b) refer the policies and procedures to the independent review committee for its review and input.
- (2) The manager may change its policies and procedures if the manager provides a written description of any material change to the independent review committee for review and input before implementing the change.

Commentary

1. *Section 2.2 contemplates that a manager should identify for each investment fund all conflict of interest matters required to be referred to*

the IRC under section 5.1 and review its policies and procedures for those matters with the IRC.

2. *A manager is expected to establish policies and procedures that are appropriate for the investment funds it manages. An example is a manager that manages more than one investment fund may establish one policy and procedure for an action or category of actions for all of the investment funds it manages. Alternatively, the manager may establish a separate policy and procedure 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 violations of securities legislation by the manager and the investment fund, to detect violations that have occurred, and to promptly correct any violations that have occurred.

3. *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) minutes of its meetings, if any;
- (b) a copy of the policies and procedures required under subsection 2.2(1); 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 each of the manager and the investment fund is adhering to this Instrument and in identifying weaknesses in the manager's written policies and procedures if violations do occur.*
2. *The CSA expect a manager to keep records of any otherwise prohibited or restricted transactions described in subsection 5.1(1) for which the manager has sought the approval of the IRC under Part 6 of this Instrument or under Part 4 of NI 81-102. (Such transactions are: inter-*

fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters).

2.4 Manager to provide assistance

- (1) If a manager refers a conflict of interest matter or any other matter that securities legislation requires it to refer to the independent review committee, 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 proposed course of action; and
 - (iii) all further information requested by the independent review committee;
 - (b) make its senior 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 that complies with this Instrument.

Commentary

1. *A manager is expected to establish an IRC using a structure that works for the investment funds it manages, having regard to the expected workload of that committee. For example, a manager that manages more than one investment fund may establish one IRC for all of the investment funds it*

manages. Alternatively, the manager may establish an IRC for each of its investment funds, or groups of its investment funds.

2. *This Instrument does not impose any restrictions on who may act as a member of the IRC, provided that the IRC meets the minimum requirements set out in this Instrument. Depending on the circumstances, any of the individuals listed in Commentary 3 to section 1.5 potentially could act as the IRC.*

This Instrument does not prevent investment funds from sharing an IRC with another investment fund manager. Managers of smaller families of investment funds may find this a cost-effective way to set up IRCs for their funds.

3.2 Initial appointment

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

3.3 Nominating criteria

Before appointing a member of the independent review committee, 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 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 3.3 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.*

3.4 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, a description of the functions that are the subject of the agreement must be included in the charter.
- (3) The independent review committee, in adopting the charter, 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. The CSA would expect an IRC acting for more than one investment fund complex to establish a separate charter for each fund complex.*
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:*
 - *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;*
 - *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; and*
 - *policies and procedures that describe how the IRC is to report to any existing advisory board or board of directors of the investment fund and the manager.*

3.5 Composition

- (1) An independent review committee must have at least three members.
- (2) The size of the independent review committee is 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 the independent review committee appointed under subsection (4) is responsible for managing the mandate and responsibilities of the independent review committee.

Commentary

1. *To ensure its effectiveness, a manager should consider the workload of the IRC when determining its size.*
2. *The CSA would expect the IRC chair to be the primary person to interact with the manager on issues relating to the investment fund. The CSA anticipate that the chair will have regular communication with the manager, as a way of keeping 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 discussing or holding meetings with other persons who can help the members understand matters that are beyond their specific expertise, or help them understand industry practices or trends, for example.*

3.6 Term of office and vacancies

- (1) The term of office of a member of an independent review committee must be not less than 2 years and not more than 5 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.
- (2) An independent review committee must fill a vacancy on the independent review committee as soon as practicable.
- (3) A member whose term has expired, or will soon expire, may be reappointed by the remaining members of the independent review committee.
- (4) 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. *The manager will appoint the first members of an IRC and, 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 (4) will rarely occur—generally only 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. Consistent with good governance practices, the CSA expect the IRC to consider the manager's recommendation, if any, when filling a vacancy.*

The CSA believe that the self-selection of members of the IRC fosters an environment in which independent-minded committees will be focussed 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 CSA recommend that all members of an IRC be appointed with staggered terms. Staggered terms ensure continuity and continued independence from the manager. Terms of appointment may also differ.*

3.7 Standard of care

- (1) Every member of an independent review committee, in exercising their powers and discharging their duties as a member of the independent review committee,
 - (a) must act honestly and in good faith, with a view to the best interests of the investment fund; and
 - (b) owes a duty to the investment fund (and not to any other person) to 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 3.4.
- (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 analogous to corporate directors, albeit with a more limited mandate, and therefore we would usually expect the common law 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.*

3.8 Ceasing to be a member

- (1) An individual ceases to be a member of an independent review committee when
 - (a) the member resigns;
 - (b) the member is removed in accordance with subsection (2);
 - (c) the member ceases to be a member under subsection (3);
 - (d) the member's term of office expires and the member is not reappointed;
 - (e) the investment fund terminates;
 - (f) the manager of the investment fund changes, unless the new manager is an affiliate of the former manager; or
 - (g) there is a change of control of the manager of the investment fund.
- (2) A member of an independent review committee can be removed from the committee

- (a) by vote of a majority of the other members of the independent review committee; or
 - (b) by vote of a majority of the securityholders of the investment fund voting 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) considered no longer independent within the meaning of section 1.5 and the cause of 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; or
 - (c) bankrupt.
- (4) When an individual ceases to be a member of the independent review committee due to a circumstance described in paragraph (1)(a), (b), (c) or (d), 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 the notification 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)(b) must comply with the notice requirements set out in section 5.4 of National Instrument 81-102 *Mutual Funds*.

Commentary

1. *In the circumstances described in paragraphs 3.8(1)(f) and (g), 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 3.6(4).*
2. *Paragraph 3.8(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 (one-time) conflict of interest matter being considered by the IRC.*

3.9 Authority

- (1) An independent review committee has authority to

- (a) obtain information it determines useful or necessary from the manager and its senior 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;
 - (d) set reasonable compensation and proper expenses for the members of the independent review committee; and
 - (e) communicate directly with the securities regulatory authority or regulator with respect to any matter.
- (2) The independent review committee must consider the manager's recommendation, if any, in setting the compensation and expenses referred to in paragraphs (1)(c) and (1)(d).

Commentary

1. *In order to avoid undue influence from the manager, paragraph (1)(d) specifies that the members of the IRC have the sole authority for determining their compensation. The manager may, however, recommend to the members of the IRC the amount and type of compensation to be paid.*

The CSA expect the IRC to decide, in a manner consistent with good governance practices, its compensation considering the manager's recommendation, if any. Among the factors a committee should consider when determining the appropriate level of compensation are the following:

- *the nature of the investment fund and the investment fund's complexity,*
- *the workload of the members of the IRC, and*
- *the best interests of the investment fund.*

2. *The CSA recognize using 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 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 who is

free from conflicting loyalties. Paragraph (1)(b) gives the IRC the choice and authority to hire independent legal counsel.

3. *Paragraph (1)(e) is intended to encourage the members of the IRC to inform the securities regulatory authority or regulator of any concerns that the IRC is not otherwise 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.*

3.10 Fees and expenses to be paid by the investment fund

The investment fund must pay from the assets of its fund

- (a) the compensation and expenses referred to in paragraph 3.9(1)(c) and (1)(d) payable to the members of the independent review committee and to any advisors employed by the independent review committee;
- (b) the costs of the orientation and continuing education of the members of the independent review committee referred to in section 3.12; and
- (c) any other costs the independent review committee may reasonably incur.

Commentary

1. *The Instrument does not prohibit a manager from reimbursing the investment fund for the fees and expenses payable to the IRC or for the costs of the orientation and continuing education of the members of the IRC. The prospectus should disclose whether or not the manager will reimburse the investment fund.*

3.11 Indemnification and insurance

- (1) An investment fund and manager may indemnify a member of the independent review committee, a former member, and their successors and legal representatives, 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 individual is involved because of being or having been a member of the independent review committee.
- (2) An investment fund and manager may advance moneys to a member of the independent review committee for the costs, charges and expenses of a proceeding referred to in subsection (1). The individual must repay the moneys if the individual does not fulfill the conditions of subsection (3).

- (3) An investment fund and manager may not indemnify a member of the independent review committee under subsection (1) 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 individual had reasonable grounds for believing that the individual's conduct was lawful.
- (4) An investment fund or manager may, with the approval of a court, indemnify an individual referred to in subsection (1), or advance moneys under subsection (2), in respect of an action by or on behalf of the investment fund to procure judgment in its favour, to which the individual is made a party because of the individual's association with the investment fund as described in subsection (1) against all costs, charges and expenses reasonably incurred by the individual in connection with such action, if the individual fulfills the conditions set out in subsection (3).
- (5) Despite subsection (1), an individual referred to in that subsection is entitled to an indemnity from the investment fund and manager in respect of all costs, charges and expenses reasonably incurred by the individual in connection with the defence of any civil, criminal, administrative, investigative or other proceeding to which the individual is subject because of the individual's association with the investment fund as described in subsection (1), if the individual seeking indemnity
- (a) was not judged by the court or other competent authority to have committed any fault or omitted to do anything that the individual ought to have done; and
 - (b) fulfills the conditions set out in subsection (3).
- (6) An investment fund and manager may purchase and maintain insurance for the benefit of any member of the independent review committee referred to in subsection (1) against any liability incurred by the member in his or her capacity as a member of the independent review committee.
- (7) An investment fund, manager or an individual referred to in subsection (1) may apply to a court for an order approving an indemnity under this section and the court may so order and make any further order that it sees fit.

Commentary

1. *This Instrument requires that members of an IRC*

be accountable for their actions. At the same time, the Instrument does not prevent an investment fund or a manager limiting a member's financial exposure through insurance and indemnification.

2. *This section permits an investment fund and the manager to indemnify or purchase insurance coverage for the members of the IRC. The CSA would 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 or investment fund to provide the protection permitted by this section.*

3.12 Orientation and continuing education

- (1) The manager must provide a member of the independent review committee as part of a member's orientation, with educational or informational programs that enable a member to understand the nature and operation of the manager's and investment fund's businesses.
- (2) The manager and independent review committee must provide a new member of the independent review committee as part of a member's orientation, educational or informational programs that enable a member to understand
 - (a) the role of the independent review committee and its members; and
 - (b) the role of each individual member.
- (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 3.12 sets out only the minimum education programs that a manager and IRC are expected to provide for members of the independent review committee. This Instrument does not restrict a manager or IRC from providing educational programs to IRC members on an ongoing basis. 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 (2)(b) to include 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 determination under section 5.2 or its recommendation under section 5.3 to the manager on a conflict of interest matter which the manager refers to the independent review committee for review.
- (2) The independent review committee must perform any other function
 - (a) required by securities legislation; or
 - (b) as may be agreed in writing between the independent review committee and the manager.
- (3) The independent review committee must deliberate and decide on a matter referred to in subsection (1) in the absence of the manager or any entity related to the manager.
- (4) 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.
- (5) An independent review committee must hold at least one meeting annually in the absence of the manager, any representative of the manager or any entity related to the manager.

Commentary

1. *The Instrument requires the IRC 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 should have a mandate that is broader than what is required under the Instrument. For example, the IRC may monitor the administration and management of the investment funds or give general advice to the manager. This Instrument does not preclude those arrangements, provided the members of the IRC continue to meet the definition of independence and the standard of care set out in this Instrument.*
3. *Subsection (3) 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 considered to be independent under this Instrument. The CSA believe using 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 in subsection (5) that the IRC meet at least once a year, without anyone else present (including management of the investment fund), is intended to afford the members of the IRC an opportunity to speak freely about any sensitive issues of concern to any of them, including any concerns about the manager.*

4.2 Regular assessments

- (1) The independent review committee must monitor and assess, at least annually, the adequacy and effectiveness of
 - (a) the manager's written policies and procedures required under section 2.2;
 - (b) any standing instructions it has provided to the manager under section 5.4; and
 - (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.
- (2) The independent review committee must review, at least annually, its effectiveness as a committee, as well as the effectiveness and contribution of each of its members.
- (3) The review by the independent review committee required under subsection (2) must include a consideration of
 - (a) the independent review committee's written charter referred to

in section 3.4;

- (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 in 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 regularly perform. Subject to these requirements, the IRC may establish a process for (and determine the frequency of) 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, an IRC member should consider factors such as attendance and participation in meetings, educational activities and industry knowledge.*

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 usefulness of the materials provided to the members of the IRC,*
 - *the collective experience and background of the members of the committee,*
 - *the number of funds the committee oversees, and*
 - *the amount and form of compensation the members receive from an individual investment fund and in aggregate from the fund complex.*
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 supervision.*

In rare circumstances, the IRC may consider removing a member of the IRC as contemplated under paragraph 3.8(2)(a) 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) 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 has become aware, or that it suspects;
- (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 has become aware, or that it suspects; 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 on the independent review committee's activities for the financial year that includes:
 - (a) the name of each member of the independent review committee at the date of the report, including the identity of the 'Chair', the member's length of service on the independent review committee and any changes in the composition or membership of the independent review committee;
 - (b) the aggregate compensation paid to the independent review committee;
 - (c) a description of 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;

- (d) if known, a description of each instance when the manager proceeded to act 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;
 - (e) if known, a description of each instance when the manager proceeded to act 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
 - (f) a description of any standing instructions the manager relied upon during the period.
- (2) The report required under subsection (1) must as soon as practicable upon the report being prepared
- (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 internet site, if it has an internet site;
 - (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 security regulatory authority or regulator should be filed on the SEDAR group profile number of the investment fund as a continuous disclosure document. Any reasonable costs associated with the filing of the report are expected to be paid by the investment fund.*
2. *The report is to be displayed prominently on the internet site of the investment fund, the investment fund family's internet site or the manager's internet site, as applicable. The CSA expect the report to remain on the internet site at least until the posting of the next report.*

4.5 Reporting to securities regulatory authority

- (1) The independent review committee must, as soon as practicable, notify in writing the securities regulatory authority or regulator if the independent review committee becomes aware of an instance where the manager proceeded to act in a conflict of interest matter under subsection 5.2(1) but did not meet a condition imposed by securities legislation (including this Instrument) or the independent review committee in its approval.
- (2) The notification referred to in subsection (1) is satisfied if the notification is made to the investment fund's principal regulator.

Commentary

1. *Subsection (1) is intended to capture a breach of a condition imposed for an otherwise prohibited or restricted transaction described in subsection 5.2(1), for which the manager has proceeded to act 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 or standing approval. For example, any conditions imposed for inter-fund trading under section 6.1 of this Instrument or section 4.2 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 or by the IRC on a transaction described in subsection 5.2(1) will result in the transaction having been made contrary to securities legislation. In such instances, among the actions the securities regulatory authorities or regulators may take, is to require the manager to unwind the transaction and pay any costs associated with doing so.

2. *The CSA do not view the reporting by the IRC under this section to the securities regulatory authority or regulator to prevent the manager from reporting to the securities regulatory authorities or regulators any breaches by the manager or investment fund of securities legislation.*

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 materials and any written reports provided to it; and
- (d) copies of materials, written reports and the determinations made by it.

Commentary

1. *Section 4.6 sets out the minimum requirements regarding the record keeping of an IRC. The CSA expect records to be kept with regard to existing best practices.*
2. *The CSA expect the IRC to keep records of any otherwise prohibited or restricted transactions in securities legislation described in subsection 5.2(1) for which the manager has sought the approval of the IRC under Part 6 of this Instrument or under Part 4 of NI 81-102. Such transactions include: inter-fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters.*

Part 5 Conflict of interest matters

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

Subject to section 5.4, if 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 applicable 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 determination.

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 in a conflict of interest matter.*

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. Paragraph (a) is intended to mandate this view.

2. *The CSA expect that, consistent with good governance practices, a determination of at least a majority of the IRC will represent a decision of the members of the IRC.*
3. *There may be matters that are subject to a securityholder vote under Part 5 of National Instrument 81-102 Mutual Funds that may also involve a “conflict of interest matter” under this Instrument. For example, increases in the charges of the manager to the mutual fund for costs incurred in operating the fund may be a conflict of interest matter as well as a matter subject to a securityholder vote. For these matters, the CSA would expect a manager to include a description of the IRC’s determination in the written notice to securityholders referred to in section 5.4 of NI 81-102.*

5.2 Matters requiring independent review committee approval

- (1) If the proposed action by the manager in a conflict of interest matter under section 5.1 is
 - (a) an inter-fund trade as described in section 6.1 of this Instrument or a transaction as described in subsection 4.2(3) of National Instrument 81-102 *Mutual Funds*;
 - (b) a transaction in securities of a related issuer as described in section 6.2 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(4) of National Instrument 81-102 *Mutual Funds*

the manager may not proceed with the proposed action without the approval of the independent review committee.

- (2) An independent review committee must not approve an action described in subsection (1) 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.*
2. *If the IRC does not approve a proposed transaction described in subsection (1), the manager is not permitted to proceed, subject to exemptive relief. 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 it approves a transaction described in subsection (1), the independent review committee will have requested from the manager or other persons 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 of a proposed action, so that an action satisfactory to both the manager and the IRC can be found, if possible.*

5. *The CSA consider the ability of the manager to seek the removal of a member or members of the IRC under paragraph 3.8(2)(b) 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) For any proposed action by the manager in a conflict of interest matter 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 opinion of the independent review committee, 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,

before the manager may proceed with the action.
- (2) If the manager decides to proceed with an action in a conflict of interest matter that, in the independent review committee's view, does not achieve a fair and reasonable result for the investment fund under paragraph (1)(a), the independent review committee may require the manager to notify securityholders in the investment fund of the manager's decision.
- (3) A notification under subsection (2) 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.
- (4) The investment fund must, as soon as practicable, file the notification referred to in subsection (3) with the securities regulatory authority or regulator upon the notice being sent to securityholders.
- (5) The manager must pay the costs associated with the filing referred to in subsection (4).

Commentary

1. *This section captures all conflict of interest matters faced by the manager other than those listed in section 5.2. 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. For example, this might include the following:*
 - *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 commissions 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 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.

For a proposed action in a conflict of interest matter under this section that is prohibited or restricted by securities legislation, a manager will still have to seek exemptive relief from the securities regulatory authority or regulator before proceeding.

2. *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, if the IRC determines that the proposed action is sufficiently important to warrant notice to securityholders in the investment fund, it has the authority to require the manager to give such notification before proceeding with the action.*

The CSA expect instances of the manager proceeding with a proposed course of action with a negative recommendation of the IRC to be rare and to occur only in exceptional circumstances.

3. *The notification referred to in subsection (4) 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) The independent review committee may provide the manager with a written standing instruction permitting, on a continuing basis, a particular action by the manager in a conflict of interest matter, on such terms and conditions as the

independent review committee requires. For the purposes of this Instrument, a standing instruction means the approval or recommendation required from the independent review committee, under sections 5.2 or 5.3, as the case may be.

- (2) Despite section 5.1, the manager is not required to refer a conflict of interest matter or its proposed action to the independent review committee before proceeding to act if the independent review committee has provided a written standing instruction that is in effect and permits that action in that conflict of interest matter.
- (3) For any course of action for which the independent review committee has provided a standing instruction, at the time of the independent review committee's regular assessment under paragraph 4.2(1)(b),
 - (a) the manager must inform the independent review committee in writing of each instance it has acted in reliance on the standing instruction; and
 - (b) before the manager may continue to act in reliance on subsection (2), the independent review committee must
 - (i) review and assess the adequacy and effectiveness of the manager's written policies and procedures with respect to that course of action;
 - (ii) review and assess the adequacy and effectiveness of the standing instruction;
 - (iii) monitor and assess the manager's compliance with the standing instruction;
 - (iv) reaffirm its approval or recommendation for the action; and
 - (v) make any appropriate amendments to the standing instruction and, if appropriate, confirm in writing to the manager that the manager may continue to rely upon the standing instruction.

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 approval or recommendation. 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 initiate 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 determining its approval or recommendation for the action or category of action under subsections 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.*

The CSA also expect the IRC to consider the conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities by the investment fund when contemplating appropriate terms and conditions, before providing or continuing a standing instruction to the manager for an action or category of actions referred to in subsection 5.2(1).

3. *As part of the IRC’s review under paragraph (3)(b), the IRC is expected to be mindful of its reporting obligation under section 4.5 of this Instrument, which includes notifying the securities regulatory authority or regulator in the investment fund’s principal jurisdiction of any instance where the manager, in proceeding with an action, did not meet a condition imposed by the IRC in its positive recommendation or approval (or 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) 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(1);

- (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, which for the purposes of this paragraph is,
 - (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 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 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;
- (f) the transaction is subject to market integrity requirements, which for the purposes of this paragraph are,
 - (i) if the security is exchange-traded,
 - (A) the purchase or sale is printed to a marketplace that executes trades of the security; and
 - (B) the purchase or sale is subject to the market conduct and display requirements of the marketplace, its regulation services provider and securities regulatory authorities; or

- (ii) if the security is foreign exchange-traded, 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 reported to a dealer, if the purchase or sale is required to be reported by a registered dealer under applicable securities laws; 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 first two in an easily accessible place;
- (2) The provisions of National Instrument 21-101 *Marketplace Operations*, and Part 6 and Part 8 of National Instrument 23-101 *Trading Rules*, do not apply to a portfolio manager or adviser of an investment fund, or an investment fund, with respect to a purchases or sale of a security referred to in subsection (1) if the purchase or sale is made in accordance with that subsection.
- (3) 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 (1) if the purchase or sale is made in accordance with that subsection.

Commentary

1. *The term “inter-fund self-dealing investment prohibitions” is defined in this Instrument. It is intended to capture the prohibitions in the securities act of each securities administrator regarding inter-fund trades.*
2. *This section is intended to exempt investment funds from the prohibitions in the securities act of each securities administrator 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 amongst fund families of a manager provided the purchase or sale is made in accordance with subsection (1).

3. *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.*
4. *The CSA expect that the IRC may give its approval in the form of a standing instruction as described in section 5.4, to give the manager greater flexibility to take advantage of perceived market opportunity.*
5. *Paragraph (1)(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.*
6. *The CSA consider the requirements in paragraph (1)(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)(f)(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).*
7. *Paragraph (1)(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 good 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 securities 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, the independent review committee has approved the investment under subsection 5.2(1);
 - (b) the purchase is made on an exchange on which the security of the issuer is listed and traded; and

- (c) no later than the time the investment fund files its annual financial statements, the manager of the investment fund files with the security 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 Quebec, Article 236 of the Regulations does not apply to a portfolio adviser or registered person acting under a management contract with respect to an investment referred to in subsection (1) on behalf of an investment fund, if the investment is made in accordance with that subsection.

Commentary

1. *The term “mutual fund conflict of interest investment restrictions” is defined in National Instrument 81-102 Mutual Funds. This section is intended to relieve investment funds in Quebec, and mutual funds elsewhere in Canada, from the prohibitions in the securities act of each securities administrator that preclude investments in securities of related issuers.*
2. *This section sets out the minimum conditions for purchases to proceed without regulatory exemptive relief. The CSA anticipate that the IRC will consider the conditions in past exemptive relief orders, waivers or approvals granted to the investment fund for such transactions, when contemplating the appropriate terms and conditions of its approval.*

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)(c) should be filed on the SEDAR group profile number of the investment fund, as a continuous disclosure document.*

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

- (1) A manager or an investment fund that has obtained an 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 regulated by this Instrument, may no longer rely on the exemption, waiver or approval as of the earlier of
- (a) one year after this Instrument comes into force; and
 - (b) the date on which the investment fund first begins to comply with this Instrument.
- (2) In British Columbia, subsection (1) does not apply.

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 carry out 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 to expire one year after its coming into force, except in British Columbia. In British Columbia, the exemptions and waivers will be revoked by a separate order rather than through the operation of this Instrument.

Part 8 Effective date

8.1 Effective date

This Instrument comes into force on [].

8.2 Transition

- (1) Despite section 8.1, for an investment fund that was established before the date this Instrument comes into force,
 - (a) the appointment by the manager of the first members of the independent review committee in accordance with section 3.2 must occur within six months from the date this Instrument comes into force; and
 - (b) the adoption by the independent review committee of a written charter in accordance with subsection 3.4(1) must occur within three months from the date the independent review committee is formed under paragraph (a).
- (2) Despite section 2.2 and section 5.1, for investment funds that are established before the date this Instrument comes into force,
 - (a) the policies and procedures to be established by the manager must be in place; and
 - (b) the referral by the manager to the independent review committee of conflict of interest matters must begin,

within six months from the date that the independent review committee adopts its written charter under subsection 3.4(1).
- (3) Despite section 4.4, for all investment funds subject to this Instrument, the first report to securityholders by the independent review committee that is required to be prepared in accordance with this Instrument must be prepared on or before the 120th 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 established before the date this Instrument comes into force must at the time that it first intends to comply with this Instrument, if before the expiration of the transition period, notify the securities regulatory authority or regulator in writing of its intention.
- (5) The notification referred to in subsection (4) is satisfied if the notification is made to the investment fund's principal regulator.

Commentary

1. *For an investment fund established after the date this Instrument comes into force, the CSA contemplate that the investment fund will be compliant with this Instrument before any purchase order for securities of the investment fund is accepted.*

Section 8.2(with the exception of subsection (3)) is intended to address the transitional concerns for investment funds established before the date this Instrument comes into force.

2. *Subsection (1) allows a manager of an existing investment fund six months from the date this Instrument is in force to appoint the initial members of the IRC, and gives the IRC three months from its formation to adopt a written charter.*

While a nine month transitional period exists for the appointment of IRC members and the IRC's adoption of its charter, the CSA strongly encourage a timely appointment of the IRC by the manager so that there is sufficient time for the IRC to review (subject to manager referral) any existing conflict of interest matters that are the subject of exemptive relief. Subsection 7.2(1) specifies that existing exemptions, waivers or approvals on any conflict of interest matters contemplated by this Instrument will expire one year after the Instrument comes into force, except in British Columbia, where the existing exemptions, waivers or approvals will be revoked by a special order.

3. *Subsection (2) allows a manager of an existing investment fund an extra six months from the IRC's adoption of its charter to establish its written policies and procedures on any existing matters now required to be referred to the IRC and for such referrals to begin to occur. This additional transitional period is intended to give the manager sufficient time to refer existing and new conflict of interest matters to the IRC for its review and determination.*
4. *Subsection (3) is a transitional section for all investment funds subject to this Instrument.*
5. *An investment fund established before the date this Instrument comes into force has a total transition period of fifteen months to comply with the Instrument. Only if the manager of an investment fund intends to comply with the Instrument before the expiry of the transition period is the notice in subsection (4) required.*