ALBERTA SECURITIES COMMISSION
NOTICE

MULTILATERAL INSTRUMENT 81-104 AND COMPANION POLICY 81-104CP *COMMODITY POOLS*

November 15, 2002

Notice of Rule and Policy

The Commission (we) have, under section 224 of the *Securities Act* (the Act), made Multilateral Instrument 81-104 *Commodity Pools* (the Instrument) a rule under the Act. We have also adopted Companion Policy 81-104CP (the Companion Policy) as a policy under the Act.

The Instrument and Companion Policy are initiatives of the Canadian Securities Administrators (the CSA). The Instrument has been, or is expected to be, adopted as a rule or regulation in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Newfoundland and Nova Scotia and as a policy in all other jurisdictions represented by the CSA, other than Québec. All of jurisdictions represented by the CSA, other than Québec, have adopted or expect to adopt the Companion Policy as their policy.

The Commission des valeurs mobilières du Québec (the "CVMQ") participated closely in the development of the Instrument and the Companion Policy, but has not yet decided to adopt the instruments. The CVMQ must follow the new rule-making procedures now in force in Québec, which mean that the instruments must be published for a further comment period in Quebéc and approval obtained from the Quebéc Ministry of Finance. The other members of the CSA have decided to implement the Instrument and the Companion Policy as a Multilateral Instrument and Companion Policy. If the CVMQ decides to implement the Instrument and the Companion Policy and the instruments come into force in Québec, the CSA will rename the instruments as national instruments. Interested parties may contact staff at the CVMQ if they have any questions on the status of the Instrument and the Companion Policy in Québec.

The British Columbia Securities Commission did not adopt some sections of the Instrument. These sections deal with the rules for establishing new commodity pools, the proficiency requirements that apply to dealers in British Columbia selling securities of commodity pools in that province, and certain of the commodity pool prospectus and continuous disclosure requirements.

Revocation of OSC Policy Statement

The Ontario Securities Commission revoked OSC Policy Statement 11.4 Commodity Pool Programs (OSC Policy 11.4) effective the date that the Instrument comes into force. Pending the Instrument and Companion Policy coming into force, OSC Policy 11.4 will continue to operate as a guideline for commodity pools in Ontario.

Background

The CSA published for comment three versions of the Instrument and Companion Policy—once in June 1997, a second time in June 2000 and most recently in December 2001[1]. We summarized the comments received on the first two publications in the notices we published with the June 2000 and December 2001 versions of the Instrument. We summarize the comments we received during the most recent comment period in the appendix to this notice.

Substance and Purpose of the Instrument

We will regulate publicly offered "commodity pools" through the Instrument and Companion Policy. The Instrument defines "commodity pools" as specialized publicly offered mutual funds that invest in, or use, commodities and/or derivatives beyond the scope permitted by National Instrument 81-102 Mutual Funds (NI 81-102). Since commodity pools are publicly offered mutual funds, they are subject to the mutual fund rules established by NI 81-102 and other applicable securities legislation unless those rules are specifically excluded or varied by the Instrument.

The Instrument operates to allow commodity pools to follow investment objectives and strategies that may involve investing in commodities (either directly or through the use of derivatives), using derivatives and employing leverage in ways not permitted for conventional mutual funds. The specialized rules of the Instrument are intended to reflect the different investment objectives and risk profile of commodity pools when compared with mutual funds regulated by NI 81-102. These specialized rules cover, among other matters

- Seed capital requirements for a new commodity pool to link the pool's sponsor more directly with the performance of the commodity pool
- Additional proficiency requirements for salespersons selling commodity pools and their supervisors to reflect the differences in the use of derivatives, commodity investing and the use of leverage
- Payment of incentive fees by commodity pools to reflect industry practice
- Redemption of units of commodity pools to allow pools to manage redemption requests
- Net asset value calculations and access to net asset value information
- More frequent and specialized financial statement requirements
- Enhanced prospectus disclosure, including additional risk disclosure and about the use of leverage.

You can read the Notices we published in December 2001[2] for descriptions of the rules contained in the Instrument, as well as the policies of the CSA set out in the Companion Policy.

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[1] In Alberta, in December 17, 2001 Summary posted on the ASC website.

[2] See above note 1.

Changes to the Instrument and the Companion Policy from the December 2001 Versions
We made two minor corrections to the Instrument and the Companion Policy—to sections 3.3 and 7.3(b) in response to comments we received. We describe these changes in the attached summary of comments. We have not otherwise changed the Instrument and the Companion Policy from the versions we published in December 2001, except to make minor drafting clarifications. The most significant clarification of this nature was to section 1.3(2). This section has been rewritten to state the interpretative provision more directly and to allow readers to understand that it relates to the application of section 2.3 of NI 81-102 to commodity pools.

Authority for the Instrument (Alberta)
Where the Instrument is to be adopted or made as a rule or regulation, the applicable securities legislation provides the securities regulatory authority with sufficient rule-making or regulation-making authority.

In Alberta, the following paragraphs of the *Securities Act* (Alberta) provide the Commission with the authority to make the Instrument:
- Section 233(f) governs commodity pools
- Section 223(g) governs derivatives
- Section 223(p) governs mutual funds

Regulations to be Revoked or Amended
The Commission will amend section 158 of the ASC Rules (General) to the Act in conjunction with the making of the Instrument as a rule by adding the following after subsection 158(6)

"(7) Subsections (1) to (6) do not apply to a commodity pool subject to Multilateral Instrument 81-104 Commodity Pools."

Instrument and Companion Policy
The texts of the Instrument and the Companion Policy follow.

Summary of comments
Changes to Proposed National Instrument 81-104 *Commodity Pools*
Published for comment on December 14, 2001

We asked for comments on the changes to National Instrument 81-104 Commodity Pools (now Multilateral Instrument 81-104) and its Companion Policy that we proposed in December 2001. The comment period ended on March 18, 2002. We received two letters providing comments from three commentators. Mondiale Asset Management Ltd. and First Horizon Capital Corp. wrote one letter and the other letter was from Fogler, Rubinoff in its capacity as counsel to Friedberg Mercantile Group. We thank the commentators for their comments.

You can get copies of these comment letters, along with the comment letters sent to us about earlier versions of the proposed Instrument, from the website of the Ontario Securities Commission at www.osc.gov.on.ca.

We summarize all of the comments provided and explain our responses to those comments in this Appendix. We have made three minor corrections or clarifications to the Instrument suggested by the commentators, but did not otherwise change the Instrument or the Companion Policy, except to make minor drafting clarifications.

1. Clarity of investment restrictions

One commentator asked that we clarify whether section 2.1 operates to restrict the underlying exposure of a commodity pool to a certain type of security or instrument to 10 percent or less.

Our response:
We responded in June 2000 to a similar comment made after we first published the Instrument for comment. The 10 percent concentration restriction in subsection 2.1(1) of National Instrument 81-102 would restrict a commodity pool from investing in any one issuer more than 10 percent of its net assets. The general rules applicable to mutual funds also apply to commodity pools. However, this concentration restriction would not preclude a commodity pool from exposing more than 10 percent of its net assets to a commodity. We believe that section 2.2 of the Companion Policy provides the clarity the commentator requests.

2. Expand the seed capital group for a new commodity pool

One commentator suggested that the group of companies and persons able to provide the required seed capital for a new commodity pool be expanded to include affiliates and associates of the group listed in subsection 3.2(1).

Our response:
We have not made this change. We intend that persons and companies with the actual responsibilities for administering or managing the commodity pool be those required to provide the initial capital for the pool. When we first published the Instrument for comment, we explained that we want to align the

interest of promoters of the commodity pool with that of investors. We do this by requiring that the promoter of a pool, or a closely related party, will itself be an investor in the pool at all times.
The commentator also pointed out an incorrect section reference in section 3.3 that we have corrected.

3. The B.C. Securities Commission's approach towards salespersons and dealers selling commodity pools is supported

Two commentators encouraged the other provincial securities commissions to adopt the approach of the British Columbia Securities Commission to allow all persons and firms registered to sell mutual funds to sell commodity pools without any additional requirements. The commentators repeated the comments they made after the June 2000 publication of the Instrument. The CSA should not impose additional proficiency requirements for sellers of commodity pools when they do not impose such requirements on sellers of other mutual funds that make extensive use of derivatives.

Our response:
The British Columbia Securities Commission has implemented its December 2001 decision. However, the other provincial regulators, including the Commission, continue to believe that commodity pools are different from conventional mutual funds, including those that are primarily derivatives based mutual funds. Commodity pools can use derivatives, invest in commodities and use leverage to carry out a much broader range of strategies than can conventional mutual funds. We explained our views on the need for additional proficiency of salespersons and dealers in the Notices we published in June 2000 and in December 2001.

4. References to "the" local jurisdiction

One commentator pointed out a reference to "the" local jurisdiction instead of "a" local jurisdiction in subsection 4.1(2).

Our response:
The current references in the Instrument to "the" local jurisdiction are correct. All National and Multilateral Instruments are written to refer to the local jurisdiction (being the province or territory) where the reader is present.

5. Add the phrase "or make available" to subparagraph 7.3(b)

One commentator suggested that we add the phrase "or make available" to subparagraph 7.3(b).
Our response:
We have replaced the word "provide" in subparagraph 7.3(b) with the phrase "make available".

6. Clarify two phrases used in sections 8.4 and 8.5

One commentator asked that we clarify the meaning of the phrase "total volume" used in section 8.4 and of the phrase "the significance of the maximum and minimum levels of leverage to the commodity pool" used in subsection 8.5(1).

Our response:

The phrase "total volume" means the appropriate aggregate measure of sales or purchases of a security, a commodity or a derivative contract. Where a commodity pool uses a derivative instrument to obtain exposure to a commodity, then the commodity pool would list the contract entered into, by the type of contract and underlying interest.

We expect a commodity pool to provide information that is specific to that commodity pool about the effect of the maximum and minimum levels of leverage experienced by the pool during the reporting period set out in subsection 8.5(1). This disclosure may include a discussion about the risks of the use of leverage during the period. We do not expect a commodity pool to include "boilerplate" disclosure about the use of leverage without tailoring that disclosure to the experience of the commodity pool during a period.

In order to clarify our expectations for prospectus disclosure of the commodity pool's past use of leverage, we have added paragraph 9.2(b)(iii). A commodity pool prospectus should cross-refer a reader to the information about the actual levels of leverage employed by the commodity pool over the time periods covered by the relevant financial statements.

7. Strong support for leverage disclosure

Two commentators strongly supported the increased disclosure of the leverage employed by a commodity pool. The commentators noted that the primary risk in alternative investing is the use of excessive leverage relative to the strategy being employed.

8. Refine commodity pool prospectus disclosure

All three commentators suggested refinements to the prospectus disclosure required of commodity pools.

Two commentators suggested that the disclosure to be provided on the front page of a commodity pool prospectus by section 9.1 contained "dire warnings" that should be replaced by more useful educational information. The commentators noted that the required language does not reflect the fact that commodity pools employ a wide spectrum of strategies with varying risk levels. They pointed out that conventional mutual funds whose investment objectives carry a substantial degree of risk are not required to include such face page risk disclosure. The commentators also asked us to re-evaluate the required disclosure about fees and charges.

Our response:

We have not changed the face page disclosure requirements in response to this comment. The Instrument gives commodity pools considerable freedom to use alternative investment strategies and does not restrict the fees and charges that can be borne by a commodity pool. Disclosure is critical to our regulation of commodity pools. Alternative investment strategies can produce wide fluctuations in returns to investors and substantially higher risk of loss. We believe that front page disclosure is warranted to alert investors of the differences between investing in commodity pools and conventional mutual funds. A commodity pool may include other information on the front page of its prospectus,

including information that the commodity pool believes is more educational and tailored to the particular commodity pool's strategy. We also question the commentators' assertion that compliance departments of dealers tend to rate all commodity pools as high risk because of the required face page disclosure.

Another commentator suggested that we require the disclosure mandated by subparagraph 9.1(d) only in circumstances when the commodity pool is executing trades outside of Canada and the United States. The commentator pointed out that U.S. exchanges have a strong level of regulation and therefore the disclosure should only relate to markets outside of the U.S. The commentator also asked why this disclosure is required for commodity pools, but not for conventional foreign equity mutual funds trading through foreign markets.

Our response:
We have not changed the face page disclosure requirements in response to this comment. The disclosure accurately points out that Canadian regulators (including Canadian exchanges) have no jurisdiction over foreign exchanges and markets, including U.S. markets and exchanges. If a commodity pool were to execute trades primarily in the United States, it could state this fact. The balance of the required disclosure would point out that Canadian regulators have no jurisdiction over the United States markets or exchanges. We would expect a commodity pool in this position to use substantially the same words as provided in subparagraph 9.1(d) to explain this information for investors. Our prospectus requirements for commodity pools differ from those of conventional mutual funds due to the different investment strategies and risks that are applicable to commodity pools.

One commentator suggested that the language in subparagraph 9.2(o) is unduly complicated and asked if it would be sufficient to require disclosure of the securities of the commodity pool held by the subject persons or companies.

Our response:
Subparagraph 9.2(o) requires disclosure about commodity pool compliance with the seed capital requirements for commodity pools. Disclosing only the securities of the commodity pool invested in by those persons will not adequately address compliance with this section, since we intend for investors to better understand the relationship between the pool sponsor and the performance of the pool.

9. Amend the exempting provision

One commentator noted the technical difficulties that service providers to mutual funds encounter in seeking exemptions from National Instrument 81-102. The commentator pointed out that National Instrument 81-102 only imposes restrictions and requirements on mutual funds themselves. Accordingly, service providers to mutual funds cannot seek exemptions on a blanket basis for those mutual funds. The commentator suggested that we fix this perceived problem in the Instrument.

Our response:
The commentator correctly points out that its concern applies to National Instrument 81-102, in addition to the Instrument. We are aware of the technical issue and are considering whether to amend applicable National Instruments to provide a solution.

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