NOTICE

NATIONAL INSTRUMENT 81-105 AND COMPANION POLICY 81-105CP

MUTUAL FUND SALES PRACTICES

Implementation of National Instrument

On December 10, 1997, the Alberta Securities Commission (the "Commission") approved an Alberta Securities Commission rule concerning mutual fund sales practices, effective May 1, 1998. The text of the rule, which is known as National Instrument 81-105, and its Companion Policy 81-105CP is published in the Alberta Securities Commission Summary of February 20, 1998 and is anticipated to be published in the Alberta Gazette dated April 15, 1998.

The National Instrument and Companion Policy are both initiatives of the Canadian Securities Administrators (the "CSA"). The National Instrument has been or is expected to be adopted as a rule in each of British Columbia, Alberta, Ontario and Nova Scotia, as a Commission regulation in Saskatchewan, and a policy in all other jurisdictions represented by the CSA. The Companion Policy will be implemented as a policy in all of the jurisdictions represented by the CSA. The National Instrument and Companion Policy is expected to come into force in all jurisdictions on May 1, 1998. Implementation may be delayed in Saskatchewan in order for the Saskatchewan Securities Commission to follow its new regulation making process.

Background

The CSA published drafts of the National Instrument and Companion Policy in July 1997 (these drafts are referred to as the "Proposed National Instrument" and "Proposed Companion Policy", respectively).[1] The Proposed National Instrument and the Proposed Companion Policy were based upon local Ontario Securities Commission ("OSC") proposed Rule 81-503 Sales Practices Applicable to the Sale of Mutual Fund Securities and proposed Companion Policy 81-503CP, respectively, which were released for comment by the OSC on August 30, 1996.

During the comment period on the Proposed National Instrument and the Proposed Companion Policy, which ended on September 30, 1997, the CSA received 23 comment letters. Appendix A of this Notice lists the commenters on the Proposed National Instrument and Proposed Companion Policy. The comments provided in these submissions were considered and the final versions of the National Instrument and Companion Policy being published with this Notice reflect the decisions of the CSA in this regard. Appendix B to the Notice provides a summary of the comments received and the response of the CSA.

Substance and Purpose of National Instrument

The National Instrument regulates the sales and business practices followed both by managers and principal distributors of publicly offered mutual funds, and by registered dealers and their sales representatives, in connection with the distribution of securities of publicly offered mutual funds. The National Instrument makes mandatory, on an industry-wide and national basis, restrictions on certain sales and business practices followed by participants in the mutual fund industry in Canada.

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[1] In Alberta, in the Alberta Securities Commission Summary for the week ending July 25, 1997

For additional information concerning the background of the National Instrument, reference should be made to the Notice issued in connection with the request for comment in July 1997.

Substance and Purpose of Companion Policy

The Companion Policy emphasizes that the National Instrument establishes only minimum standards of conduct for industry participants. The Companion Policy is designed to provide regulatory background and context for the National Instrument and to outline the CSA's general regulatory purpose in making the National Instrument. The Companion Policy also provides guidance as to the CSA's interpretation of some provisions of the National Instrument and brings certain matters to the attention of participants in the mutual fund industry.

Summary of Changes to National Instrument from Proposed National Instrument

This section describes changes made in the National Instrument from the Proposed National Instrument. For a summary of the contents of the Proposed National Instrument, reference should be made to the Notice published in July, 1997. As the changes to the National Instrument from the Proposed National Instrument are not material, the National Instrument is not subject to a further comment period.

Section 2.3

Changes from the Proposed National Instrument

Section 2.3 of the Proposed National Instrument has been deleted from the National Instrument. Section 2.4 of the Companion Policy sets out the CSA's views in connection with indirect actions taken by industry participants to circumvent direct prohibitions under the National Instrument. The CSA have made this change as section 2.3 of the Proposed National Instrument was viewed as a re-statement of existing principles of law and, as such, it was not required to be stated in this or any other rule made or to be made by the CSA or any of its constituent members. The CSA have expressed their position in the Companion Policy that an attempt by an industry participant to effect indirectly any action that it is directly prohibited from doing under the National Instrument will be seen as a breach of the National Instrument.

Section 3.2

Section 3.2 of the National Instrument permits the payment of trailing commissions, subject to certain conditions contained in paragraphs 3.2(1)(a) through (d). Paragraph 3.2(1)(d) provides, among other things, that the rate of a trailing commission may not increase based upon increases in the amount or value of securities of a mutual fund sold, or held in accounts of clients of a participating dealer. This paragraph would prevent mutual fund organizations from declining to pay trailing commissions to a participating dealer on the basis that the amount or value of securities held in accounts of the participating dealer or its representatives was less than a specified threshold.

Changes from the Proposed National Instrument

The CSA have added subsection 3.2(3) to the National Instrument in order to provide a limited transitional exception to the general provisions of section 3.2 in respect of minimum asset thresholds. Subsection 3.2(3) permits a member of the organization of a mutual fund to decline to pay a trailing commission in connection with securities of the mutual fund held in client accounts of a participating dealer in certain circumstances; namely, where the non-payment is in accordance with a policy concerning minimum asset thresholds established by the mutual fund organization on or before July 1, 1997 and still in effect on that date, and where the securities with respect to which no trailing commission is paid have been acquired by the client of the dealer before the National Instrument came into force.

The CSA have added subsection 3.2(3) in order to ensure that the National Instrument does not retroactively disrupt existing arrangements between mutual fund organizations and participating dealers with respect to securities acquired before the National Instrument came into force.

Section 4.2

Subsection 4.2(1) of the National Instrument prohibits a principal distributor of proprietary funds, that also acts as a participating dealer in the distribution of third party sponsored mutual funds, from paying incentives to its representatives that could cause the representatives to favour the proprietary funds over the third party funds.

Changes from the Proposed National Instrument

The CSA have added subsection 4.2(2) to the National Instrument in order to clarify the operation of subsection 4.2(1). Subsection 4.2(2) sets out a limited exception to subsection (1), in order to permit the compensation paid to a representative of a principal distributor to reflect commissions received by the principal distributor from members of the organization of which it is a member, as well as from members of the organization of other mutual funds, provided that the following two conditions are satisfied.

First, paragraph (a) of subsection 4.2(2) requires that a principal distributor must pay to its representative the same percentage of the commission which it receives from all mutual fund families, including the mutual fund family for which it is the principal distributor. Second, paragraph (b) requires that the commissions paid to the principal distributor of the mutual fund securities must not exceed the commissions provided to any other participating dealer in connection with the distribution of those securities.

Sections 5.2 and 5.5

Section 5.2 of the National Instrument permits a member of a fund organization to provide a non-monetary benefit to a representative of a participating dealer by allowing him or her to attend a conference or seminar organized and presented by a member of the organization of a mutual fund, upon certain conditions. Section 5.5 of the National Instrument allows a mutual fund organization to pay, to a participating dealer, direct costs incurred by the participating dealer relating to a conference or seminar that is organized and presented by the participating dealer for its representatives, upon certain conditions. Each of sections 5.2 and 5.5 of the National Instrument impose a condition that the conferences or seminars to which those sections apply must be held in the geographic locations specified in the National Instrument.

Changes from the Proposed National Instrument

The Proposed National Instrument required that these conferences or seminars be held in Canada or the continental United States of America. Sections 5.2 and 5.5 of the National Instrument have been amended to also permit these conferences or seminars to take place in a location where a portfolio adviser of the mutual fund carries on business if the primary purpose of the conference or seminar is the provision of educational information about the investments or activities of the mutual fund carried on by that portfolio adviser. These amendments have been made to permit so-called portfolio manager "due diligence" conferences to continue to be offered or paid for by mutual fund organizations.

Section 5.4

Section 5.4 of the National Instrument permits a member of the organization of a mutual fund to pay to the Investment Funds Institute of Canada ("IFIC"), the Investment Dealers Association of Canada (the "IDA"), or their respective affiliates or associates, direct costs incurred by IFIC, the IDA, or their respective affiliates or associates relating to a conference or seminar organized by IFIC, the IDA, or their respective affiliates or associates, subject to certain conditions.

Changes from the Proposed National Instrument

The CSA have made two technical changes to section 5.4. First, the CSA have provided that section 5.4 does not override section 5.3, which permits mutual fund organizations to pay registration fees for conferences, seminars and courses. Second, the references contained in subsection 5.4(2) to IFIC and the IDA have been extended to include their respective affiliates or associates.

Section 6.1

Section 6.1 of the National Instrument is designed to minimize the conflicts that may occur when a participating dealer acts as a broker in connection with portfolio transactions involving a mutual fund, where that participating dealer has also distributed securities of that mutual fund. Subsection 6.1(3) requires that sharing of information, relating to portfolio transactions, between a member of the organization of a mutual fund and a participating dealer or a principal distributor occur through the individuals designated by the participating dealer or principal distributor as their respective institutional representatives.

Changes from the Proposed National Instrument

The CSA have amended subsection 6.1(3) of the National Instrument to clarify that the prohibitions contained in that subsection are only directed at particular trades. The subsection does not prevent the sharing of general information relating to, for example, trading history.

Section 7.1

Section 7.1 of the National Instrument provides that a participating dealer or its representatives may pay all or part of the redemption fees or commissions that may be payable by an investor in connection with a transfer from one mutual fund to another mutual fund if certain conditions are satisfied. One of these conditions, contained in subsection 7.1(2), requires that the participating dealer or the representative, on behalf of the participating dealer, must provide the investor with written disclosure of both the redemption charges to which the investor will be subject in connection with the securities being acquired, and the tax consequences of the applicable redemption, together with a description of the current redemption fees being paid by the participating dealer or the representative.

Changes from the Proposed National Instrument

Paragraphs 7.1(2)(a) and (b) have been amended to clarify that reasonable estimates of the amount of fee or commission paid by the participating dealer on the redemption, and of the redemption charges to which the investor will be subject, must be disclosed. These changes recognize that it may be impossible to provide disclosure of exact figures or amounts.

Section 7.3

Section 7.3 of the National Instrument prohibits a member of the organization of a mutual fund from making a charitable donation if the tax benefit associated with that donation would go to a participating dealer, an associate or affiliate of a participating dealer, or a representative of a participating dealer.

Changes from the Proposed National Instrument

Section 7.3 has been amended to permit a member of the organization of a mutual fund to make charitable donations in favor of its affiliates on the basis that such inter-corporate dealings generally do not raise regulatory concerns about inappropriate sales practices.

Section 8.1

Section 8.1 of the National Instrument requires that the prospectus of a mutual fund must contain complete disclosure of two categories of information contained in paragraphs (a) and (b). Paragraph (a) relates to the commissions paid, and paragraph (b) relates to the sales practices followed by the members of the organization of the mutual fund.

Changes from the Proposed National Instrument

Paragraph 8.1(b) of the National Instrument now clarifies that a prospectus is only required to disclose the sales practices followed in connection with the distribution of the mutual fund securities that are the subject of that prospectus.

Section 8.2

Section 8.2 of the National Instrument requires prospectus disclosure and separate written point of sale disclosure of any equity interest that may exist among a member of the organization of a mutual fund, a participating dealer, a representative of the participating dealer, or their associates.

Changes from the Proposed National Instrument

The prospectus disclosure requirements contained in subsection 8.2(1) have been amended in respect of equity interests held in a member of the organization of a mutual fund that is not a reporting issuer whose securities are not listed on a Canadian stock exchange. For disclosure concerning equity interests held in those members, subsection 8.2(2) permits the equity interests of representatives and their associates to be expressed in aggregate, provided that disclosure is also made of any representative and his or her associates that hold more than five percent of the applicable class of securities.

Subsections 8.2(3), (4) and (5) have been added to the National Instrument for clarification purposes to replace subsection 8.2(3) of the Proposed National Instrument. Those subsections continue to require that a participating dealer, and the representative acting on a trade, provide a purchaser with a disclosure document if the participating dealer, representatives of the participating dealer or the particular representative involved in the trade (with their associates) have an equity interest in a member of the organization of the mutual fund or if a member of that organization has an equity interest in the participating dealer.

Part 10

Part 10 of the National Instrument is new. It states that the National Instrument will come into effect on May 1, 1998 and provides a transition period for prospectus disclosure. If a mutual fund obtains a receipt for a prospectus or simplified prospectus before the date that the National Instrument comes into force, that prospectus or simplified prospectus is not required to comply with the specific disclosure requirements contained in the National Instrument. As a result, such a prospectus is not required to be amended; compliance with these specific disclosure requirements may be delayed until the next renewal of the prospectus.

Summary of Changes to the Companion Policy from the Proposed Companion Policy

This section describes the changes made in the Companion Policy from the Proposed Companion Policy. As the changes to the Companion Policy from the Proposed Companion Policy are not material, the Companion Policy is not subject to a further comment period.

Section 2.1

Section 2.1 of the Companion Policy describes the background to the National Instrument.

Changes from the Proposed Companion Policy

Subsection 2.1(2) to the Companion Policy has been added to describe the 1991 IFIC Report and the 1991 IFIC Code, the latter of which included restrictions on locations for conferences or seminars similar to those now included in the National Instrument, as well as enhanced disclosure requirements. This subsection provides additional background to the regulation of mutual fund sales practices.

Section 2.3

Section 2.3 of the Companion Policy describes the application of the National Instrument to the sales practices followed by industry participants in connection with the sale of securities of labour-sponsored venture capital corporations ("LSVCCs"). It clarifies that most members of the CSA, other than the securities regulatory authorities in Manitoba and Quebec, consider LSVCCs to be mutual funds and regulate them as such. Accordingly, the rules set out in the National Instrument apply to LSVCCs. However, the relevant members of the CSA will consider applications to exempt LSVCCs from the operation of section 2.1 of the National Instrument in order to permit LSVCCs to pay permitted sales incentives out of fund assets, on the basis that the operational and legal structure of LSVCCs is such that LSVCCs cannot comply with section 2.1 of the National Instrument.

Changes from the Proposed Companion Policy

Section 2.3 is new.

Section 2.4

Section 2.4 of the Companion Policy discusses the CSA's views on the use of indirect means to circumvent the National Instrument.

Changes from the Proposed Companion Policy

Section 2.4 of the Companion Policy has been expanded somewhat from section 4.4 of the Proposed Companion Policy to recognize that section 2.3 of the Proposed National Instrument has been deleted from the National Instrument for the reasons outlined above. The substance of section 2.4 of the Companion Policy has not been changed from section 4.4 of the Proposed Companion Policy.

Part 5

Part 5 of the Companion Policy clarifies certain matters provided for in Part 3 of the National Instrument. Section 5.1 of the Companion Policy contains a discussion on disclosing the method of calculation for sales and trailing commissions and section 5.3 contains a discussion of trailing commission thresholds.

Changes from the Proposed Companion Policy

The CSA have added section 5.1 to the Companion Policy to clarify that the requirement to disclose the methods of calculation of commissions contained in Part 3 of the National Instrument may be satisfied through disclosure of a general nature.

Subsections 5.3(3), (4) and (5) have been added to the Companion Policy to describe the transitional exemption

provided by subsection 3.2(3) of the National Instrument in connection with minimum asset thresholds for payment of trailing commissions.

The CSA have added subsection 5.3(6) to the Companion Policy to describe the views of the CSA respecting the internal compensation systems of participating dealers that impose, in effect, an asset or sales threshold to be achieved by representatives in order to receive a commission paid by a mutual fund organization in respect of mutual fund sales.

The CSA have added subsection 5.3(7) to the Companion Policy to emphasize that there is nothing in the National Instrument that requires a mutual fund organization to pay the same rate of commission to all participating dealers selling the securities of that mutual fund's family.

Section 6.1

Section 6.1 of the Companion Policy was published as footnote 31 to the Proposed National Instrument, and has been moved into the Companion Policy. This section emphasizes that the National Instrument permits different payments to be made by participating dealers to their representatives for different mutual funds, provided that the difference in payments results from different commissions received by the participating dealer from the mutual fund organization(s).

Changes from the Proposed Companion Policy

Section 6.1 is new.

Section 7.2

Section 7.2 of the Companion Policy was published as section 6.2 of the Proposed Companion Policy. It emphasizes that section 5.1 of the National Instrument permits only certain "cooperative" marketing in connection with a sales communication, investor conference or investor seminar. Section 7.2 also emphasizes that section 5.1 of the National Instrument is not designed to enable participating dealers to recoup their general marketing costs from mutual fund organizations.

Changes from the Proposed Companion Policy

Subsection 7.2(2) has been added to the Companion Policy to clarify the position of the CSA relating to the receipts or invoices required to be provided under paragraph 5.1(c) of the National Instrument for the associated direct costs permitted to be paid by a member of the organization of a mutual fund. Subsection 7.2(2) clarifies that a participating dealer need not require head office approval for these receipts and invoices and may establish procedures to deal with these receipts or invoices at a local office level. Subsection 7.2(2) also clarifies that participating dealers may direct fund companies to pay permitted cooperative marketing monies directly to suppliers or service providers.

Subsection 7.2(3) has been added to the Companion Policy to clarify that the written disclosure required under paragraph 5.1(e) of the National Instrument is satisfied, by indicating that a clearly identified party has paid a portion of the costs of a sales communication, investor conference or investor seminar.

Section 7.3

Section 7.3 of the Companion Policy describes the views of the CSA concerning section 5.2 of the National Instrument. Subsection 7.3(2) of the Companion Policy provides clarification as to the position of the CSA regarding the selection of representatives of a participating dealer to attend a mutual fund sponsored conference under section 5.2 of the National Instrument.

Changes from the Proposed Companion Policy

Subsection 7.3(2) of the Companion Policy is new. Subsection 6.3(2) of the Proposed Companion Policy, concerning invitations to a mutual fund sponsored conference under section 5.2 of the National Instrument, has been deleted. Subsection 7.3(2) of the Companion Policy clarifies that section 5.2 of the National Instrument does not prevent mutual fund organizations from organizing events that are tailored to the interests of particular categories of representatives and from informing participating dealers as to the nature of such events.

Section 7.5

Section 7.5 of the Companion Policy elaborates on the meaning of the word "location" used in subparagraphs 5.2(c)(iii) and 5.5(e)(iii) of the National Instrument. It emphasizes that those subparagraphs permit "due diligence" trips to the immediate locale where a portfolio adviser of a mutual fund carries on business.

Changes from the Proposed Companion Policy

Section 7.5 of the Companion Policy is new and results from the changes made to sections 5.2 and 5.5 of the National Instrument concerning the geographic location for conferences and seminars permitted by those sections.

Section 8.1

Section 8.1 of the Companion Policy contains the views of the CSA on the designation of institutional representatives for the purposes of Part 6 of the National Instrument.

Changes from the Proposed Companion Policy

Section 8.1 of the Companion Policy was published as section 7.1 of the Proposed Companion Policy. Subsection 8.1(2) has been added to the Companion Policy to clarify that the CSA recognize the legitimacy of certain types of information sharing between a member of the organization of a mutual fund and a participating dealer or a principal distributor.

Part 9

Part 9 has been added to the Companion Policy to address several points in relation to Part 7 of the National Instrument.

Section 9.1 clarifies that the tax disclosure required to be provided under subsection 7.1(2) of the National Instrument will be satisfied by disclosure of a general nature.

Subsection 9.2(1) clarifies that "products or services" referred to in paragraph 7.4(b) of the National Instrument includes the opening of an account.

Subsection 9.2(2) provides a discussion regarding the ambit of section 7.4 of the National Instrument, which governs tied selling practices. Subsection 9.2(2) emphasizes that section 7.4 is not intended to interfere with legitimate "relationship pricing" where a customer obtains more favourable terms or conditions through the purchase of mutual fund securities. Subsection 9.2(2) clarifies that section 7.4 is directed at situations where a customer is denied services he or she would otherwise be able to obtain, but for the fact that the customer did not purchase mutual fund securities.

Changes from the Proposed Companion Policy

Part 9 is new.

Section 10.1

Section 10.1 of the Companion Policy discusses the disclosure required to be provided in a prospectus of a mutual fund in connection with equity interests held by participating dealers and their representatives in members of the organization of the mutual fund. It reminds industry participants that "equity interest" is defined in the National Instrument and has a different meaning depending on whether the relevant member of the organization of a mutual fund is a reporting issuer whose securities are listed on a Canadian stock exchange or not. Section 10.1 also indicates what action the CSA expect mutual funds to take in attempting to compile the required information.

Changes from the Proposed Companion Policy

Section 10.1 is new.

Revocation of CSA Notices

The CSA Notices entitled "Mutual Fund Sales Incentives" (CSA Notice 93/1, dated January 20, 1993) "Mutual Fund Sales Incentives - Point of Sale Disclosure" (CSA Notice 95/2, dated January 13, 1995) and "Sales of Mutual Funds in Upcoming RRSP Season" (CSA Notice 81-302 dated December 12, 1997) will be revoked effective the date that National Instrument 81-105 comes into force.

DATED: February 20, 1998

APPENDIX A

List Of Commenters On
Proposed National Instrument 81-105 And
Companion Policy 81-105CP

1. AGF Management Limited
2. The Association of Labour Sponsored Investment Funds
3. Berkshire Investment Group Inc.
4. Canadian Bankers Association
5. Crocus Investment Fund
6. Dynamic Mutual Funds (letter endorsed by C.I. Mutual Funds and AGF Management Limited)
7. Fidelity Investments Canada Limited
8. Fogler, Rubinoff, on behalf of Assante Capital Management Inc., Equion Securities Canada Limited, Equion Financial Limited, Brightside Financial Services Inc., DataPlan Securities Limited, Fenlon Financial Inc. and Loring Ward Investment Counsel Limited
9. Global Strategy Investment Funds
10. Independent Mutual Fund Dealers, being Ross Dixon Financial Services Limited, Associated Financial Planners, Balanced Planning, Brightside Financial, CMG/World Source, DPM Financial, Equion, Financial Concept Group, FPC Investments Inc., Keybase Financial Group, Money Concepts Group, The Rogers Group, Trillenium Investor Services, TWC Financial Corporation, The Investment Centre
11. Investment Dealers Association of Canada
12. The Investment Funds Institute of Canada
13. Investors Group Inc.
14. Mr. Joseph W.A. Killoran
15. Mackenzie Financial Corporation
16. Manulife Securities International Ltd.
17. Pacific Capital Management Ltd.
18. Ross Dixon Financial Services Limited
19. Scotia Securities Inc.
20. Stratégie GBS Courtier en fonds d'investissement
21. Trimark Investment Management Inc.
22. The VenGrowth Investment Fund Inc.
23. Working Opportunity Fund

APPENDIX B

Summary Of Comments Received, An Analysis Of The Significant Issues And Concerns Received And Response Of The Canadian Securities Administrators

I. INTRODUCTION

The CSA released the proposed National Instrument 81-105 Mutual Fund Sales Practices (the "Proposed National Instrument") and its proposed Companion Policy 81-105CP (the "Proposed Companion Policy") on July 25, 1997. The Proposed National Instrument and Proposed Companion Policy were based on the OSC proposed Rule 81-503 Sales Practices Applicable to the Sale of Mutual Fund Securities (the "Ontario Draft Rule"), together with proposed Companion Policy 81-503CP (the "Ontario Draft Policy") that was issued for comment on August 1996.

During the comment period on the Proposed National Instrument and the Proposed Companion Policy, which ended on September 30, 1997, the CSA received 23 submissions from 43 commenters.[2] The commenters can be grouped as follows:

Mutual Fund Distributors and Financial Planners	23
Individuals	1
Trade Associations	4
Mutual Fund Management Companies	12
Labour Sponsored Venture Capital Corporations	3[3]
TOTAL	**43**

The four trade associations listed, being The Investment Funds Institute of Canada ("IFIC"), the Investment Dealers Association of Canada (the "IDA"), the Canadian Bankers Association (the "CBA") and The Association of Labour Sponsored Investment Funds (the "LSIF Association"), each made submissions in respect of the Proposed National Instrument and the Proposed Companion Policy on behalf of their respective members.

Copies of the comment letters may be viewed at the office of the British Columbia Securities Commission, 1100-865 Hornby Street, Vancouver, British Columbia (604) 899-6500; the offices of the Alberta Securities Commission (in Edmonton, at 10025 Jasper Avenue, Edmonton, Alberta (403) 427-5201; in Calgary, at 400, 300-5th Avenue, S.W. Calgary, Alberta (403) 297-6454); the office of Micromedia, 20 Victoria Street, Toronto, Ontario (416) 312-5211 or (800) 387-2689; and the office of the Commission des valeurs mobilières du Québec, Stock Exchange Tower, 800 Victoria Square, 17th Floor, Montréal, Québec.

The CSA have considered the comments received on the Proposed National Instrument and the Proposed Companion Policy in conjunction with making National Instrument 81-105 Mutual Fund Sales Practices (the "National Instrument") and Companion Policy 81-105CP Mutual Fund Sales Practices (the "Companion Policy"). The CSA thank all commenters for providing their comments on the Proposed National Instrument and the Proposed Companion Policy. The nature of the comments received indicates the care and thought

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[2] Certain submissions were sent in on behalf of several parties.

[3] The submission from The Association of Labour Sponsored Investment Funds has been grouped as a trade association comment. Sixteen labour sponsored venture capital corporations are members of that association.

given by industry participants to the issues addressed by the Proposed National Instrument and the comments have been very helpful to the CSA in making the National Instrument and the Companion Policy.

The following is a summary of the comments received, together with the CSA's responses and, where applicable, the changes adopted by the CSA. As the alternatives to the Proposed National Instrument and the Proposed Companion Policy do not change the proposed rule in a material way, the National Instrument and the Companion Policy are not subject to a further comment period.

II. GENERAL COMMENTS

Most commenters on the Proposed National Instrument and the Proposed Companion Policy commented on specific provisions in these instruments and made no comments that applied generally.

However, each of IFIC, the CBA and the IDA commented that members were appreciative of the changes to the Ontario Draft Rule that the CSA incorporated in the Proposed National Instrument. In addition, these trade associations commended the CSA for agreeing to make a national rule to regulate mutual fund sales practices in a fashion consistent with the IFIC Code[4] and the Ontario Draft Rule. IFIC noted that the Proposed National Instrument and the Proposed Companion Policy were "in many ways, significantly closer" to the IFIC Code provisions and indicated its members' satisfaction with the responsiveness of the CSA to the issues raised by IFIC in connection with its comments on the Ontario Draft Rule and Ontario Draft Policy. The IDA made a similar comment, as did the CBA.

IFIC urged the CSA to proceed quickly to resolve any remaining issues with a view to adopting a final national instrument in time for the 1998 RRSP sales season. The CBA on the other hand indicated that it would like to see further discussion on the points it raised in its comment letter prior to a final national instrument being adopted. Staff of the CSA and representatives of the CBA have met to discuss the CBA's comments and the CSA have agreed to outline its views in respect of tied selling practices in the Companion Policy to provide more of a context for and explanation of section 7.4 of the National Instrument.

As outlined in the Notice of the National Instrument and the Companion Policy, each member of the CSA has made the National Instrument as a rule or a policy in its jurisdiction (depending on whether it has rule-making powers) and the Companion Policy as a policy in its jurisdiction. Subject to receiving applicable ministerial approvals where needed, the National Instrument and the Companion Policy are expected to come into force in all jurisdictions on May 1, 1998.

One individual commenter reiterated the comments made in his submissions on the Ontario Draft Rule and urged the CSA to ensure that there is "zero tolerance" for any "undisclosed independent advice skewing sales incentives and/or asset retention inducements". This commenter's central concern relates to his view that the present "transaction/commission based" mutual fund industry "lacks the investment advice, financial planning and investment management disclosure systems that are needed to elevate mutual fund sellers on the scales of respect, trust and integrity that our society accords doctors, teachers and clergy". The CSA are of the view that by making the National Instrument and the Companion Policy, the CSA are indeed illustrating that there will be "zero tolerance" of improper sales practices in the mutual fund industry. The National Instrument and the Companion Policy, when coupled with appropriate compliance and enforcement measures by the CSA, will be very significant in ensuring that investors' interests are at the forefront of the actions of industry participants.

III. COMMENTS ON PROVISIONS OF PROPOSED NATIONAL INSTRUMENT

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4 "Recommendations for a Code of Sales Practices for the Mutual Fund Industry" released by IFIC on March 29, 1996.

Part 1 - Definitions, Interpretation and Application

Section 1.1 - Definition of "member of the organization"

One commenter noted, as it had in its submission on the Ontario Draft Rule, that the term "member of the organization" was not intuitively easy to comprehend and suggested it be changed. The name of the term has not been changed; the CSA are not persuaded that any of the proposed alternatives, or any other possible alternative, is any more intuitive than "member of the organization".

Section 1.2 - Interpretation

One commenter recommended, as it had in its submission on the Ontario Draft Rule, that the Proposed National Instrument be amended to define all relevant terms in the rule, rather than cross-referring to the meaning of terms defined in other instruments. The CSA have not changed the National Instrument in this regard; to duplicate terms defined in NP39 would make the National Instrument unwieldy and more difficult to read. The approach used is also in conformity with the approach adopted for other national instruments.

Section 1.3 - Application

The labour sponsored venture capital corporation ("LSVCC") commenters primarily argued that the Proposed National Instrument should be amended to exempt LSVCCs from the operation of section 2.1 of the Proposed National Instrument. The LSIF Association restricted its comments to the potential effect on the LSVCC community of section 2.1 and purposefully did not address other aspects of the Proposed National Instrument, leaving it up to individual LSVCCs to so comment. The LSIF Association stated that, other than in respect of the application of section 2.1 of the Proposed National Instrument, "the fundamental objectives of the National Instrument, being the introduction of limitations on specific marketing and sales practices, can be fully embraced by the labour sponsored investment fund industry".

Part 2 - General

Section 2.1 - Restrictions on Payments or Provision of Benefits

The LSIF Association and the other LSVCC commenters urged the CSA to exempt LSVCCs from the application of section 2.1 which prohibits mutual funds from paying out of fund assets the enumerated distribution costs. These commenters noted that the application of this section would cause severe disruption to the operations of LSVCCs in that they would have to seek other methods of compensating participating dealers. Certain LSVCCs are "internally managed" and do not have a third party manager or administrator that could bear these costs. These LSVCCs would find it impossible to alter their structure so as to comply with the rule. Those LSVCCs that have third party managers or administrators would find the rule equally disruptive since such managers or administrators would no doubt be obliged to raise management fees charged to the LSVCCs to cover the extra expense. Increasing management fees requires shareholder approval, which would take time, money and effort to seek and would not necessarily be obtained. The LSVCCs also emphasized the specialized and unique nature recognized by the applicable provincial legislatures and their legislative purpose behind the establishment of the various LSVCC programs. Section 2.1 of the Proposed National Instrument would be contrary to this legislative purpose, by, in effect, prohibiting the current legal and organizational structure for LSVCCs.

These commenters also made the comments noted under section 1.3 in connection with their objection to section 2.1 of the Proposed National Instrument.

The CSA have taken the above-noted comments into consideration and do not wish to unduly disrupt the current operations of LSVCCs. However, rather than amending the National Instrument to provide a general exemption from section 2.1 for LSVCCs, the applicable members of the CSA that regulate LSVCCs as mutual funds, will

consider granting exemptions to each affected LSVCC from the applicability of section 2.1, such exemption to take effect on the coming into force of the National Instrument. The exemptions will be granted on the condition that the other provisions of the National Instrument will be fully complied with.

The CSA's views on the applicability of the National Instrument to LSVCCs is outlined in section 2.3 of the Companion Policy.

Part 3 - Permitted Compensation

Section 3.1 - Commissions

The CBA commented that the requirement to disclose the "method of calculation" of commissions should be deleted. The CBA was of the view that this requirement would result in disclosure of sensitive competitive information that would not be relevant information for investors. This provision was never intended to require disclosure of the nature described by the CBA. The CSA have amended the Companion Policy in response to this comment to describe the CSA's expectations for disclosure of the method of calculation of commissions.

Section 3.2 - Trailing Commissions

The CBA made the same comment regarding disclosure of "method of calculation" of trailing commissions; the amendment to the Companion Policy describes the CSA's expectations regarding this disclosure for trailing commissions.

Five commenters who are mutual fund managers reiterated the comments made on the Ontario Draft Rule in respect of the lack of a $100,000 asset threshold for payment of trailing commissions as is permitted by the IFIC Code. Neither IFIC nor the IDA repeated the comments concerning this issue made in their submissions on the Ontario Draft Rule.

The five commenters again urged the CSA to reconsider the decision not to permit fund companies to impose a minimum asset threshold. These commenters made arguments similar to those made in connection with the Ontario Draft Rule. The comments made and the response of the CSA to those comments are summarized in the OSC Notice issued in connection with the request for comment.[5]

The commenters on the Proposed National Instrument emphasized four points that are in addition to, or an expansion on, the comments made on the Ontario Draft Rule.

(1) Smaller fund companies will be most affected by the rule, as proposed, for two reasons. The total dollar cost of having to increase the amount of trailing commissions paid out will impact smaller fund managers to a greater extent. In addition, a dealer representative tends to have smaller aggregate client accounts with a smaller fund manager and, as such, the trailing commissions paid by the fund manager to the representative's dealer firm will be smaller and will tend not to be paid to the representative by the dealer due to the "grid system" for representative compensation maintained by dealer firms.

(2) The "grid system" for representative compensation maintained by dealer firms means that the trailing commissions paid to dealer firms by fund companies will not be passed on to the representatives if those commissions are below a specified dollar amount. Accordingly an asset/sales threshold, in effect, exists at the dealer firm level.

(3) Fund companies pay trailing commissions to compensate representatives for the costs incurred by such representatives in providing on-going service to their clients in connection with the clients' investments

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[5] The Request for Comments was published in the OSC Bulletin at (1997) 20 OSCB 3879.

in the mutual funds managed by the fund companies. If the trailing commissions are not being passed on to representatives by the dealer firms, then the representatives are not being compensated for providing these services. Because of the effect of the compensation systems in place in dealer firms, prohibiting an asset threshold for trailing commissions at the fund company level means that dealer firms will receive extra compensation from fund companies without providing any corresponding services, and representatives will not receive compensation intended to reimburse them for their costs incurred in providing services.

(4) At an asset threshold of $100,000, the trailing commissions presently paid are so nominal that representatives are unlikely to sell purely to reach the threshold and the commissions will not likely bias the advice given.

The CSA have carefully considered the comments made on this issue and have not changed their views or the reasons for the prohibition, i.e. to permit such a threshold is akin to permitting a bonus payment which is directly prohibited under the National Instrument. However, the CSA wish to make known their concerns about compensation practices of participating dealers setting asset or sales thresholds for their representatives. Subsection 5.3(6) of the Companion Policy deals with these concerns.

Notwithstanding the CSA's decision not to change section 3.2 of the National Instrument to permit minimum asset thresholds, the CSA have changed the National Instrument in response to a comment made on the Proposed National Instrument that was not made on the Ontario Draft Rule. The CSA also have changed the Companion Policy to clarify the CSA's views in the area of trailing commissions in response to two commenters' questions that were not asked through the comments made on the Ontario Draft Rule.

Subsection 3.2(3) of the National Instrument and subsections 5.3(3), (4) and (5) of the Companion Policy are new and respond to the concerns raised in a submission by a fund manager, which was formally endorsed by two other fund managers. These fund managers asked the CSA to clarify that the trailing commissions rules contemplated by section 3.2 of the Proposed National Instrument were to apply only to trailing commissions paid on mutual fund securities purchased after the effective date of the National Instrument. The commenters indicated that not to clarify the effective date of these new rules would result in ambiguity as to whether this regulation was intended to have retroactive effect and "thereby create a deferred commission". The commenters argued that "retroactivity would be unduly harmful to mutual fund managers".

As outlined in subsection 5.3(3) of the Companion Policy, the CSA consider that the rules proposed in section 3.2 of the Proposed National Instrument were not intended to affect retroactively existing compensation arrangements between mutual fund organizations and participating dealers with respect to securities acquired before the effective date of the National Instrument. Prior to the effective date of the National Instrument, participating dealers and their representatives and fund companies agreed to certain compensation arrangements. The CSA consider that no justification exists for the National Instrument to disrupt these contractual arrangements that were entered into prior to the effective date of the National Instrument. Accordingly, subsection 3.2(3) of the National Instrument is designed to provide a limited transitional exception to the general requirements of section 3.2 of the National Instrument. The CSA note, as outlined in subsection 5.3(5) of the Companion Policy, that the National Instrument does not require fund companies to maintain asset thresholds in respect of trailing commissions payable on assets acquired prior to the effective date of the National Instrument.

Two commenters asked whether the CSA intended that fund managers be required to pay the same trailing commission to all participating dealers. The CSA are not regulating commission payments in this way, and have added subsection 5.3(7) to the Companion Policy to clarify this matter. Another commenter asked whether section 3.2 of the Proposed National Instrument permitted fund companies to make payments to different participating dealers at different times. Section 3.2 clearly permits different payment times, as long as the method of calculation and the time periods are the same for all participating dealers. The CSA consider that section 3.2 of the National Instrument is clear in this regard and have not included a discussion on this matter in the Companion Policy.

Part 4 - Internal Dealer Incentive Practices

Section 4.1 - Participating Dealers' Practices

The IDA supported the change made by the CSA to section 4.1 of the Proposed National Instrument through the inclusion of subsection 4.1(2). However, the IDA requested that subsection 4.1(2) of the Proposed National Instrument be redrafted to conform to the explanation for this subsection contained in footnote 31 to the Proposed National Instrument. The CSA consider that subsection 4.1(2) is clear, but have added section 6.1 to the Companion Policy in order that the explanatory commentary contained in the former footnote 31 be continued in the formal regulatory instruments.

Section 4.2 - Principal Distributors' Practices

Several commenters commented that an exception similar to subsection 4.1(2) should be added to section 4.2 of the Proposed National Instrument. The commenters noted that the section should permit a principal distributor to pay its own sales force in a way that recognizes that other fund companies will pay different commissions. The CSA are of the view that the inherent conflicts of interest raised by a dealer selling proprietary funds as well as third party funds is best managed through a reasonable restriction on that dealer providing incentives to a representative that may cause that representative to make inappropriate recommendations. However, the CSA accept that further clarification is necessary to this section to explain what the CSA considers to be a reasonable restriction. The CSA also accept that an exception similar to subsection 4.1(2) of the National Instrument is necessary. The changes made to this section in the National Instrument respond to these comments and clarify the CSA's intentions.

Part 5 - Marketing and Educational Practices

Section 5.1 - Cooperative Marketing Practices

A group of fifteen independent mutual fund dealers requested in a collective submission that the CSA remove section 5.1 of the Proposed National Instrument and substitute a rule that would permit a so-called "dealer development allowance" to be paid to participating dealers by fund companies.

The independent mutual fund dealers argued that ensuring compliance with section 5.1 will be costly for dealers and managers alike and that regulators will not be able to monitor or enforce compliance. These commenters asked that the CSA mandate a prescribed maximum amount that could be paid by fund managers as a dealer development allowance. Dealers would not be restricted in how they used the monies paid under a dealer development allowance. An alternative rule of this nature would be simple to understand and administer and compliance would be easier to monitor.

The IDA also voiced its concerns with section 5.1 and the practice of payment of cooperative marketing expenses by fund companies. The IDA indicated that "the IDA has consistently taken the view that the practice of cooperative marketing in support of mutual fund distribution should be discontinued. In the interest of a level playing field, the industry has not taken unilateral action on this issue, and believes that such a rule should only come into force at a time when it will apply to all parties. It is the Association's preference that cooperative marketing practices be entirely prohibited".

The CSA continued the approach of regulating sales practices as much as possible in a fashion consistent with the IFIC Code. The CSA noted in the July Ontario Notice that Glorianne Stromberg recommended a complete prohibition on the practice of cooperative marketing. Had the CSA not made a decision to make rules regulating cooperative marketing practices consistent with the IFIC Code approach to the sales practice, the CSA may have proposed different rules. At this time, however, the CSA are not prepared to prohibit cooperative marketing practices or to provide for a CSA prescribed dealer development allowance in lieu thereof.

IFIC asked the CSA to amend section 5.1 of the Proposed National Instrument to permit representatives to seek reimbursement of marketing costs covered by the section directly from fund companies, subject to appropriate monitoring by the dealer firms. IFIC suggested that since it is "standard industry practice" for representatives to pay marketing costs directly, the representatives should be able to seek reimbursement from fund companies directly. The CSA have not made this change. Ensuring separation between representatives and fund companies so that appropriate monitoring and supervision of representatives can be maintained and so that representatives are not inappropriately influenced through the provision of sales incentives by fund companies is a central and fundamental principle that runs throughout the National Instrument.

The CSA have added two interpretative provisions to the Companion Policy in response to comments from the IDA and from IFIC, both in respect of cooperative marketing.

The IDA asked for clarification of paragraph 5.1(c) of the Proposed National Instrument and for assurance that a participating dealer could set up non-head office level monitoring of cooperative marketing claims. Subsection 7.2(2) of the Companion Policy states that the CSA consider that paragraph 5.1(c) of the National Instrument does not require a participating dealer to set up head office level procedures to deal with cooperative marketing requests. Subsection 7.2(2) of the Companion Policy also responds to a comment contained in the IDA submission in that the CSA will not object to participating dealers directing fund companies to pay otherwise permitted cooperative marketing expenses directly to suppliers of participating dealers. The IDA also asked that the CSA mandate the use of a certain industry developed form in connection with cooperative marketing expenses. The CSA have not mandated this use of a form; instead, the CSA expect that the industry will take whatever steps, including the use of appropriate forms, participants feel are necessary to ensure compliance with section 5.1 of the National Instrument.

IFIC asked for clarification of what the CSA would consider appropriate compliance with the requirement in paragraph 5.1(e) of the National Instrument to disclose, in writing, the identity of those paying for a sales communication or investor seminar. Subsection 7.3(3) of the Companion Policy articulates the CSA's view that the requirement to make written disclosure of the identity of those paying for a sales communication or the costs of an investor seminar is not met through the mere insertion of a fund company logo; the disclosure should clearly identify names and state that those named entities are paying for a portion of the costs.

Section 5.2 - Mutual Fund Sponsored Conferences

Several commenters recommended changes to paragraphs 5.2(b) and (c) of the Proposed National Instrument.

IFIC and one other commenter asked that paragraph 5.2(b) of the Proposed National Instrument be deleted as an unnecessary restriction that does not recognize legitimate business relationships between fund companies and dealer representatives. These commenters suggested that the rule, as drafted, could mean that fund companies would find themselves holding educational conferences for uninterested or inappropriate dealer representatives. Paragraph 5.2(b) of the National Instrument carries forward a central theme of the National Instrument, namely that fund companies deal with dealer firms and not directly with representatives; the CSA have not amended the National Instrument in this regard. However, the CSA have added subsection 7.3(2) to the Companion Policy. This subsection describes that paragraph 5.2(b) of the National Instrument would not prevent fund companies from organizing events that are tailored to the interests of particular categories of representatives and advising the dealer of the nature of those events. Identifying or contacting specific representatives would not be permitted.

Several commenters disagreed with the restriction on the geographic location of mutual fund sponsored conferences contained in paragraph 5.2(c) of the Proposed National Instrument. Two commenters asked that the restriction be deleted entirely and argued that if the other restrictions provided for in section 5.2 were adhered to, the location of the conference would be irrelevant and neutral. On the other hand, two commenters, including IFIC, acknowledged the CSA's concern about the locale for mutual fund sponsored conferences, even

where, as required by section 5.2, mutual fund companies are not paying any of the travel or accommodation costs of representatives. One commenter noted that it supported the principle that fund companies should not host conferences in exotic locales such as Hawaii and the Caribbean. IFIC acknowledged that "there may be a legitimate concern in preventing trips to exotic destinations chosen solely because they are out of the normal routine".

Commenters, including IFIC, asked that if the restriction were not deleted entirely, exceptions should be provided in the National Instrument for so-called "due diligence" trips organized by fund managers to international locations, either to permit representatives to review the operations of third party portfolio managers at that location or to experience international markets first-hand.

The CSA have accepted IFIC's and the other commenters' recommendation that the National Instrument permit fund managers to organize due diligence trips to international locations where a fund's portfolio adviser is located and carries out the portfolio management for the fund. Subparagraph 5.2(c)(iii) of the National Instrument has been added as a limited exception to the general restriction on the location for such conferences. The CSA are not prepared at this time to permit more wide-ranging due diligence trips to international locations whereby fund managers would allow representatives to be exposed to the international capital markets as requested by one commenter. Section 7.5 of the Companion Policy has been added to clarify the CSA's views on the meaning of the word "location" as used in the above-noted limited exception.

One commenter asked for clarification whether the CSA consider Alaska to form part of the continental United States. The CSA are of the view that it does.

Section 5.3 - Third Party Sponsored Educational Events

IFIC, and one other commenter, noted an apparent inconsistency between the permission given fund companies in section 5.3 of the Proposed National Instrument to pay the registration fees incurred by dealers or their representatives in taking educational courses and the prohibition contained in subsection 5.4(1) of the Proposed National Instrument against fund companies paying costs incurred in connection with seminars, conferences and courses organized by IFIC, the IDA or other trade associations. The CSA did not intend this result and accordingly has amended section 5.4(1) of the National Instrument to give precedence to the rule contained in section 5.3 of the National Instrument.

IFIC also asked that section 5.4 of the Proposed National Instrument be amended to permit industry participants to pay for the costs incurred by IFIC affiliates in connection with the provision of seminars and conferences. The CSA have so amended section 5.4 in the National Instrument and have included a similar amendment to permit industry participants to pay the costs incurred by IDA affiliates.

Section 5.5 - Participating Dealer Sponsored Events

Two comments were made regarding the restriction on the geographic location for dealer sponsored events contained in paragraph 5.5(e) of the Proposed National Instrument. IFIC made the same comments as noted above under the summary of comments made on section 5.2 of the Proposed National Instrument. The other commenter urged that the location restriction be removed in favour of a per person dollar limit for the costs of organizing a conference. The commenter noted that it could be more expensive and involve longer travel time to travel to resorts located in the continental United States than locations in the Caribbean and Mexico. The commenter suggested that the restriction could be viewed as an unauthorized interference with international trade or as contrary to the North American Free Trade Agreement.

The CSA are not regulating all conferences held by a dealer for its own representatives; but only those conferences where the dealer is seeking monetary contributions from fund companies. The CSA consider that section 5.5 of the National Instrument is an appropriate restriction on the ability of Canadian dealers to seek reimbursement from Canadian mutual fund companies for their costs of holding conferences for their Canadian

based representatives. The CSA are not making rules that infringe upon international trade or that prevent free trade between the signatories to the North American Free Trade Agreement.

The CSA analysis outlined above concerning the need for a geographic restriction for mutual fund sponsored conferences is applicable to the geographic location restriction for participating dealer sponsored conferences. The CSA have made the same limited exception as described above to permit dealers to seek reimbursement (subject to the percentage limits set out in paragraphs 5.5(b) and (c) of the National Instrument) from fund companies in respect of due diligence trips to international locations where fund portfolio advisers are located.

Section 5.6 - Promotional Items and Business Promotion Activities

One individual commenter again urged the CSA, as he did in his submissions on the Ontario Draft Rule, to restrict the provision of promotional items and promotional activities by fund companies, noting that these items and activities constitute "investorism integrity abusing mutual fund sales incentive/asset retention enhancing inducements". The commenter suggested that the CSA review the Canadian Medical Association's Code of Ethics and its 1994 Policy Summary entitled "Physicians and the Pharmaceutical Industry" before finalizing the Proposed National Instrument and in particular before adopting section 5.6 of the Proposed National Instrument. The commenter gave an example of a particular fund company's "asset retention inducement" he believed was inappropriate and was made available to representatives in 1996. As outlined in the July Ontario Notice, the CSA continue to be of the view that the regulatory approach set out in section 5.6 of the National Instrument is appropriate for the mutual fund industry at this time but will monitor sales practices in this regard.

Part 6 - Portfolio Transactions

Section 6.1 - Reciprocal Commissions and Portfolio Transactions

IFIC again asked, as it did in its submission on the Ontario Draft Rule, that section 6.1 of the Proposed National Instrument be amended to contemplate permission for fund companies and dealers to carry out "necessary communications" concerning portfolio transactions. The CSA have not amended section 6.1 of the National Instrument in this regard, but have added subsection 8.1(2) to the Companion Policy to ensure that the CSA's views in connection with this comment as set out in the July Ontario Notice are carried forward into the formal regulatory instruments.

Part 7 - Other Sales Practices

Section 7.1 - Commission Rebates

IFIC again asked, as it did in its submission on the Ontario Draft Rule, that the obligation to obtain a client's written consent before an applicable redemption of securities as required by subsection 7.1(1) of the Proposed National Instrument be deleted. It noted that clients tend to resist having to provide written consent to transactions. The CSA have not deleted this requirement; written consent is essential in ensuring that a client understands the implications of the applicable redemption transaction.

One commenter pointed out the "logical impossibility" of disclosing the precise amount of redemption fees being paid for and to be paid upon redemption of the securities being acquired, prior to the purchase taking place. The CSA have amended subsection 7.1(2) of the National Instrument to require disclosure of a reasonable estimate of these amounts. The CSA have also included section 9.1 of the Companion Policy in response to this commenter's request for an explanation as to the CSA's expectations for the tax disclosure required to be given under subsection 7.1 (2) of the National Instrument.

IFIC's submission as well as two submissions from mutual fund dealers urged the CSA to delete the restrictions contained in section 7.1 of the Proposed National Instrument on a participating dealer and its representatives paying a commission rebate to a client, where the participating dealer is a member of the organization of a

mutual fund and the client is switching into a fund within the mutual fund family of that fund organization. These commenters argued that the restriction is not reflective of reality and unfairly imposes a financial burden upon clients who wish to switch to the sponsored products from other mutual fund products. One commenter suggested that the rule be changed to restrict sales by representatives on a commission rebated basis to certain defined limits. The other commenter suggested that the rule be changed to permit commission rebates by representatives without restriction, as long as the representative is not being reimbursed for the payment by the related fund organization. This commenter's submission is largely based upon the assumption that a representative is largely uninfluenced by his or her related fund organization on whether or not to recommend a sponsored product over a third party sponsored product and whether or not to offer a commission rebate to a client.

The CSA continue to have policy concerns about members of a fund organization, including dealer and representative members of that fund organization, providing an incentive to a client by way of a commission rebate, to switch investments into sponsored products. Subsection 7.1(3) of the National Instrument prohibits a fund organization from directly making these commission rebates; the CSA see no difference in the policy rationale for such a prohibition when the commission rebate is being made, not by the fund organization directly, but by a representative or a participating dealer that is a member of that fund organization. Notwithstanding the arguments made in the above submissions, the CSA are of the view that it is not unrealistic to assume that a participating dealer and its representative may be influenced by the related fund organization to recommend switches to sponsored products. The CSA wish to remove any potential for concern that investors will agree to such a switch due to the financial incentive represented by a commission rebate when the switch is not necessarily in the client's best interests.

The CSA have not changed section 7.1 to accommodate these submissions, but point out that they will consider granting relief to provide an exemption for any industry participant that demonstrates that its operations are such that the policy concerns articulated above are minimized.

One commenter stated that section 7.1 should not prohibit a representative from paying a rebate on a redemption when the client is liquidating his portfolio without buying any other mutual fund securities. The CSA note that section 7.1 will not prohibit the payment of a rebate on such redemptions as section 7.1 only applies on redemptions occurring in connection with the purchase of other mutual fund securities.

Section 7.3 - Charitable Donations

The CBA asked that section 7.3 of the Proposed National Instrument be amended to permit charitable donations between affiliates, as is permitted by section 7.2 of the Proposed National Instrument in connection with the provision of financial assistance. The CSA have amended section 7.3 of the National Instrument to respond to this comment in order not to interfere with intercorporate funding issues that do not raise regulatory concerns about inappropriate sales practices.

Section 7.4 - Tied Selling

The CBA and one other financial institution affiliate mutual fund manager commented on section 7.4 of the Proposed National Instrument. The CBA asked that the CSA "withhold" the effective date of section 7.4 in order to facilitate further discussions between the CSA and the industry on this section. The CBA noted that in their view, a legislative approach to tied selling (in the nature of section 7.4) should only be considered where there is clear evidence of continuing investor protection problems with tied selling practices and industry developed solutions do not work. It pointed out that it was working on an industry statement on tied selling and a program of self-regulation in response to a federal government proposal to amend the Bank Act to regulate loan-making practices of financial institutions. The CBA and the other commenter also noted that they were very concerned about the meaning of the words "or on terms that appear to a reasonable person to be a condition" contained in section 7.4 of the Proposed National Instrument. The commenters were of the view that this test was "unworkable" in practice and failed to provide certainty to persons packaging products for customers.

The CSA have added section 9.2 of the Companion Policy to describe their views on the nature of the tied selling activities being regulated by section 7.4 of the National Instrument. This section is provided to give guidance to industry participants as to the CSA's intentions regarding the scope of section 7.4. This section carries forward the CSA's views described in the July Ontario Notice that the CSA accept legitimate "relationship pricing", but that the CSA remain concerned about the potential for coercion in connection with the provision of services related to the sale of mutual fund securities. Staff of the CSA discussed this approach with representatives of the CBA. Although the CBA has not altered its primary position, namely that section 7.4 should be removed from the National Instrument, it confirmed the usefulness of an explanation as to the CSA's views in the Companion Policy.

Part 8 - Prospectus and Point of Sale Disclosure

Section 8.1 - Disclosure of Sales Practices

The CBA, IFIC and another commenter asked that the CSA clarify the expectations as to the disclosure to be provided under section 8.1 of the Proposed National Instrument. In particular these commenters asked for clarification that the requirement to include a "complete description" in a mutual fund's prospectus of compensation payable and sales practices followed would not necessitate disclosure concerning the compensation payable by parties other than the mutual fund's fund organization or the sales practices followed by the mutual fund's fund organization in respect of other securities. Section 8.1 of the National Instrument is clearly intended to require disclosure of compensation payable and sales practices followed by a mutual fund's fund family in connection with the distribution of that fund's securities. The CSA have added appropriate clarifying words to section 8.1 in the National Instrument to ensure that the scope of this section is properly understood.

IFIC and the CBA again asked that the National Instrument contain transitional provisions so that fund companies would not be immediately required to amend prospectuses to comply with section 8.1 of the National Instrument. The CSA appreciate the concerns raised, and although they are of the view that the required disclosure is important and is in large part now being provided in fund prospectuses, have added section 10.2 to the National Instrument to respond to this comment.

Section 8.2 - Disclosure of Equity Interests

One commenter outlined the extreme difficulty its organization would be subject to if section 8.2 of the Proposed National Instrument remained as drafted having regard to the fact that over 300 individual representatives associated with that organization have equity interests (as defined) in members of the organization of the relevant mutual fund family. The CSA have re-considered the objectives for the disclosure contemplated by subsection 8.2(1) of the National Instrument and have amended that section to require disclosure of equity interests held by representatives of participating dealers in members of a fund organization that are not public companies on a collective basis and not individually. A mutual fund is required, however, to disclose the equity interests held by any representative that holds more than 5 percent of the outstanding shares of a non-public member of a fund organization. The CSA have not changed the requirement that an individual representative must disclose his or her equity interest in a member of the organization of a mutual fund in the disclosure document contemplated to be provided to purchasers under subsection 8.2(3) of the National Instrument.

Section 10.1 of the Companion Policy has been added to further clarify the disclosure requirements of section 8.2 of the National Instrument.

Section 8.3 - Disclosure Requirements If No Prospectus or Simplified Prospectus

IFIC again recommended, as it did in its submission on the Ontario Draft Rule, that section 8.3 of the Proposed National Instrument be deleted. IFIC noted that it could not see the policy rationale for requiring disclosure of

sales practices for mutual fund securities being distributed under a prospectus exemption, particularly when arguably more important information is not required to be disclosed under applicable securities legislation. The CSA have retained section 8.3 in the National Instrument. The potential for conflicts of interest associated with the sales practices used in exempt mutual fund transactions is sufficiently serious and in reality no different from public transactions (that is, those carried out under a prospectus) that the requirement for the disclosure provided for in this section remains appropriate.

IV. COMMENTS ON PROVISIONS OF THE PROPOSED COMPANION POLICY

Part 2 - General Discussion of the Instrument

Section 2.1 - Background

IFIC asked that the chronology of events described in section 2.1 of the Proposed Companion Policy refer to the 1991 code of sales practices developed by IFIC. The CSA have included this reference in section 2.1 of the Companion Policy.

Section 2.2 - General Purpose of the Instrument

IFIC asked that paragraph 2.2(2)(b) of the Proposed Companion Policy be redrafted to read "a participating dealer and its representatives have a primary obligation to act in the best interests of the clients". The CSA have made this drafting change.

Part 4 - Discussion of Certain Aspects of Part 2 of the Instrument

Section 4.2 - Non-Monetary Benefits

IFIC asked that the word "normal" be deleted from subsection 4.2(3) of the Proposed Companion Policy. The CSA have made this drafting change.

IFIC also asked that subsection 4.2(5) of the Proposed Companion Policy be deleted. IFIC argued that fund companies should be able to provide dealers with educational software in any form. IFIC pointed out that it was “incongruous” that the Proposed National Instrument permits fund companies to pay the registration fees incurred by dealers in connection with the attendance of representatives at educational courses, but the CSA does not permit educational software to be given to dealers. The CSA have not made this change; software that does not fall within the parameters described in subsections 4.2(4) and (6) of the Companion Policy, and could not be considered a business promotional item of minimal value in accordance with section 5.6 of the National Instrument, would likely be a non-monetary benefit and therefore would not be permitted under the National Instrument.

Part 6 - Marketing and Educational Practices [now Part 7 of the Companion Policy]

Section 6.3 - Mutual Fund Sponsored Conferences [now section 7.3 of the Companion Policy]

Two commenters urged the CSA to delete subsection 6.3(2) of the Proposed Companion Policy. Subsection 6.3(2) of the Proposed Companion Policy was intended to remind fund companies that section 5.2 of the Proposed National Instrument does not permit a fund company to invite a guest of a representative to a mutual fund sponsored conference. The CSA have deleted this provision from the Companion Policy, on the basis that section 5.2 of the National Instrument requires attendees at fund sponsored conferences to pay their own travel, accommodation and personal incidental expenses. Section 5.2 of the National Instrument does not permit fund organizations to invite directly representatives or guests of representatives. The CSA considers that attendees at mutual fund conferences should be free to travel with their guests, provided that no costs associated with guest travel are paid for by the fund organizations. A discussion in the Companion Policy as to the CSA's views on guests of attendees is not necessary.