

Nova Scotia Securities Commission

**Rule 81-105
Mutual Fund Sales Practice**

-and-

**Companies Policy 81-105CP
Mutual Fund Sales Practices**

WHEREAS:

1. Pursuant to section 150 of the *Securities Act*, R.S.N.S. 1989, chapter 418, as amended (the "Act"), the Nova Scotia Securities Commission (the "Commission") has power to make rules subject to compliance with the requirements of the Act;
2. Pursuant to section 19 of the Act, the Commission has power to issue and publish policy statements;
3. National Instrument 81-105, Mutual Fund Sales Practices and National Policy 81-105 CP, Mutual Fund Sales Practices, copies of which are attached hereto and are hereinafter called the "Rule" and "Companion Policy" respectively, have been adopted as rules by one or more of the Canadian securities regulatory authorities.
4. The Commission is of the opinion that the attainment of the purpose of the Act is advanced by this Instrument.

NOW THEREFORE the Commission hereby

- (a) pursuant to the authority contained in section 150 of the Act and subject to compliance with the requirements of section 150A of the Act, approves the Rule and makes the same a rule of the Commission except insofar as the Rule contains coming into force or effective date provisions;

(b) pursuant to the authority contained in section 19 of the Act and subject to publication in the *Royal Gazette*, issues the Policy as a policy statement of the Commission except insofar as the Policy contains coming into force or effective date provisions; and

(c) declares that the rule approved and made pursuant to clause (a) and the policy statement issued pursuant to clause (b) shall both take effect on **June 1, 2000**

unless the Governor-in-Council disapproves the rule or returns it to the Commission in accordance with subsection 150A(3) of the Act in which event the rule and the policy statement shall not be effective until the rule is approved by the Governor-in-Council.

IN WITNESS WHEREOF this Instrument has been signed by all of the members of the Commission, the last of whom signed the same on the **10th** day of **March, 2000**.

"Robert B. MacLellan"

Robert B. MacLellan

"K. Kachafanas"

Kiki Kachafanas

Attachments

NATIONAL INSTRUMENT 81-105
MUTUAL FUND SALES PRACTICES
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**NATIONAL INSTRUMENT 81-105
MUTUAL FUND SALES PRACTICES**

PART 1 DEFINITIONS, INTERPRETATION AND APPLICATION

1.1 Definitions - In this Instrument

"direct costs" means reasonable, out-of-pocket costs and expenses directly attributable to

- (a) the production and presentation of a sales communication referred to in Part 5, or
- (b) the presentation and organization of a conference or seminar referred to in Part 5, other than any travel, accommodation or personal incidental expenses associated with the attendance of an individual at the conference or seminar;

"equity interest" means, in relation to an issuer

- (a) if the issuer is a reporting issuer in any jurisdiction and its securities are listed on a Canadian stock exchange, the direct or indirect ownership of securities representing more than ten percent of any class of voting securities, equity securities or partnership units of the issuer, or
- (b) for all other issuers, the direct or indirect ownership of a voting security, equity security or partnership unit of the issuer;

"equity security" means a security of an issuer that carries a residual right to participate in the earnings of the issuer and, upon the liquidation or winding up of the issuer, in the distribution of its assets;

"IDA" means the Investment Dealers Association of Canada;

"IFIC" means The Investment Funds Institute of Canada;

"member of the organization" means, for a mutual fund

- (a) the manager of the mutual fund,
- (b) the principal distributor of the mutual fund,
- (c) the portfolio adviser of the mutual fund,

- (d) an affiliate of any of the persons or companies referred to in paragraph (a), (b) or (c), or
- (e) a person or company that is organized by a member of the organization of the mutual fund as a vehicle to fund payment of commissions to participating dealers and that has a right to arrange for the distribution of the securities of the mutual fund;

"mutual fund family" means two or more mutual funds that have

- (a) the same manager, or
- (b) managers that are affiliates of each other; and

"representative" means, for a participating dealer,

- (a) a partner, director, officer, salesperson or employee of the participating dealer, and
- (b) any company through which a person referred to in paragraph (a) carries on activities in connection with services provided to the participating dealer.

1.2 Interpretation - Terms defined in National Policy Statement No. 39, or in a successor instrument to that policy statement, and used in this Instrument have the respective meanings ascribed to them in National Policy Statement No. 39 or the successor instrument, whichever is in force.

1.3 Application - This Instrument applies to

- (a) a distribution of securities of a mutual fund that offers or has offered securities under a prospectus or simplified prospectus for so long as the mutual fund remains a reporting issuer; and
- (b) a person or company in respect of activities pertaining to a mutual fund referred to in paragraph (a).

PART 2 GENERAL

2.1 Restrictions on Payments or Provision of Benefits

- (1) No member of the organization of a mutual fund and no mutual fund shall, in connection with the distribution of securities of the mutual fund

- (a) make a payment of money to a participating dealer or a representative of a participating dealer;
 - (b) provide a non-monetary benefit to a participating dealer or a representative of a participating dealer; or
 - (c) pay for or make reimbursement of a cost or expense incurred or to be incurred by a participating dealer or a representative of a participating dealer.
- (2) Despite subsection (1), a member of the organization of a mutual fund may
- (a) make a payment of money or provide a non-monetary benefit to a participating dealer, or pay for or make reimbursement of a cost or expense incurred or to be incurred by a participating dealer or its representatives, if permitted by Part 3 or 5; and
 - (b) provide a non-monetary benefit to a representative of a participating dealer, if permitted by Part 5.
- (3) A member of the organization of a mutual fund shall not, and shall not represent that it may, make a payment, provide a non-monetary benefit or pay for or make reimbursement of a cost or expense otherwise permitted by subsection (2) that is conditional on
- (a) the sale of a particular amount or value of securities of one or more mutual funds by a participating dealer or a representative; or
 - (b) a particular amount or value of securities of one or more mutual funds being held in accounts of clients of a participating dealer or a representative.

2.2

Restrictions on Solicitation and Acceptance of Payments or Benefits

- (1) No participating dealer and no representative of a participating dealer shall solicit or accept from a mutual fund or a member of the organization of the mutual fund, in connection with the distribution of securities of the mutual fund, the payment of money, the provision of a non-monetary benefit or payment or reimbursement for a cost or expense incurred or to be incurred by the participating dealer or representatives of the participating dealer.
- (2) Despite subsection (1),

- (a) a participating dealer may solicit and accept a payment of money, provision of a non-monetary benefit or payment or reimbursement for a cost or expense incurred or to be incurred by it or its representatives from a member of the organization of the mutual fund, if the member is permitted by Part 3 or 5 to make the payment, provide the benefit or make the payment or reimbursement; and
- (b) a representative of a participating dealer may accept the provision of a non-monetary benefit from a member of the organization of the mutual fund, if the member is permitted by Part 5 to provide the benefit.

2.3 Application of Instrument to Some Participating Dealers or Representatives

- (1) Nothing in this Instrument prohibits a person or company that is both a member of the organization of a mutual fund and a participating dealer of a mutual fund in a different mutual fund family from undertaking any activity, if
 - (a) the activity is undertaken in the person or company's capacity as a participating dealer of the mutual fund of which it is a participating dealer, and not in its capacity as a member of the organization of the mutual fund of which it is a member; and
 - (b) a participating dealer is not prohibited by this Instrument from undertaking that activity.
- (2) Nothing in this Instrument prohibits a representative of a participating dealer that is also a member of the organization of a mutual fund from soliciting or accepting any payment, non-monetary benefit or reimbursement otherwise permitted by this Instrument from the participating dealer, if the payment, provision of the non-monetary benefit or reimbursement is made in the participating dealer's capacity as a participating dealer and not in its capacity as a member of the organization of a mutual fund.

PART 3 PERMITTED COMPENSATION

3.1 Commissions - A member of the organization of a mutual fund may pay to a participating dealer a commission in money for the distribution of a security of the mutual fund made through the participating dealer, if

- (a) the obligation to make the payment arises at the time of the trade;
- (b) the prospectus or simplified prospectus of the mutual fund discloses the range of rates of commissions that may be paid and the method of calculation used in determining the amount of those commissions; and

- (c) the rate of the commission does not increase
 - (i) based on increases in the amount or value of securities of the mutual fund sold, or of mutual funds in the same mutual fund family as the mutual fund sold, or of any or all of the foregoing,
 - (ii) based on increases in the amount or value of securities of the mutual fund, or of mutual funds in the same mutual fund family as the mutual fund, or of any or all of the foregoing, held in accounts of clients of the participating dealer, or
 - (iii) for a particular period of the year in which the commission is paid or earned.

3.2 Trailing Commissions

- (1) A member of the organization of a mutual fund may pay to a participating dealer a trailing commission in money that is based upon the aggregate value of securities of the mutual fund held in accounts of clients of the participating dealer as at a particular time or during a particular period, if
 - (a) the obligation to make the payment arises after the time of the trade;
 - (b) the prospectus or simplified prospectus of the mutual fund discloses the range of rates of trailing commissions that may be paid and the method of calculation and relevant times or time periods used in determining the amount of those trailing commissions;
 - (c) the method and time of calculation of the trailing commission and the relevant times or time periods used in determining the amount of the trailing commission are the same for all participating dealers of the mutual fund; and
 - (d) the rate of the trailing commission does not increase
 - (i) based on increases in the amount or value of securities of the mutual fund sold, or of mutual funds in the same mutual fund family as the mutual fund sold, or of any or all of the foregoing,

- (ii) based on increases in the amount or value of securities of the mutual fund, or of mutual funds in the same mutual fund family as the mutual fund, or of any or all of the foregoing, held in accounts of clients of the participating dealer, or
 - (iii) for a particular period of the year in which the trailing commission is paid or earned.
- (2) A member of the organization of a mutual fund may establish policies and practices concerning the timing of payments of trailing commissions so long as all trailing commissions are paid within one year from the date earned.
- (3) Despite subsection (1), a member of the organization of a mutual fund may decline to pay a trailing commission to a participating dealer in connection with securities of the mutual fund held in the accounts of clients of the participating dealer if
 - (a) the securities in respect of which no trailing commission is paid were acquired by those clients before the date that this Instrument came into force;
 - (b) the amount of securities held in the accounts of those clients is below a threshold specified in the policy referred to in paragraph (c); and
 - (c) the non-payment of the trailing commission is in conformity with a policy of the member of the organization of the mutual fund that was in place and was followed on July 1, 1997.

PART 4 INTERNAL DEALER INCENTIVE PRACTICES

4.1 Participating Dealers' Practices

- (1) No participating dealer shall provide an incentive to any of its representatives to recommend mutual funds of one mutual fund family over mutual funds of another mutual fund family.
- (2) Despite subsection (1), the compensation paid to a representative of a participating dealer by the participating dealer may reflect commissions received by the participating dealer from members of the organizations of mutual funds, so long as the compensation paid to a representative for the securities of a mutual fund sold or held, as a percentage of the commission paid to the participating dealer, is the same for all mutual fund families.

4.2

Principal Distributors' Practices

- (1) A principal distributor of a mutual fund that is also a participating dealer of another mutual fund shall not provide an incentive for any of its representatives to recommend a mutual fund of which it is a principal distributor over a mutual fund of which it is a participating dealer.
- (2) Despite subsection (1), the compensation paid to a representative of a principal distributor by the principal distributor may reflect commissions received by the principal distributor from members of the organization of which it is a member and members of organizations of other mutual funds if
 - (a) the compensation paid to a representative for the securities of a mutual fund sold or held, as a percentage of the commission paid to the principal distributor, is the same for all mutual fund families, including the mutual fund family of the principal distributor; and
 - (b) the commissions paid to the principal distributor in connection with the distribution of securities of a mutual fund of which it is a principal distributor are not in excess of the commissions provided to any participating dealer in connection with the distribution of those securities.

PART 5

MARKETING AND EDUCATIONAL PRACTICES

5.1

Cooperative Marketing Practices - A member of the organization of a mutual fund may pay, to a participating dealer, direct costs incurred by the participating dealer relating to a sales communication, investor conference or investor seminar prepared or presented by the participating dealer, if

- (a) the primary purpose of the sales communication, investor conference or investor seminar is to promote, or provide educational information concerning, the mutual fund, the mutual fund family of which the mutual fund is a member or mutual funds generally;
- (b) in the case of an investor conference or investor seminar, the conference or seminar is presented by the participating dealer to investors or potential investors of the mutual fund, another mutual fund in the same mutual fund family, or of mutual funds generally;
- (c) the participating dealer provides invoices for, or receipts evidencing payment of, the direct costs to be paid by a member of the organization of the mutual fund;

- (d) the aggregate direct costs of the sales communication, investor conference or investor seminar paid by all members of organizations of mutual funds do not exceed 50 percent of the total direct costs incurred by the participating dealer; and
- (e) the sales communication discloses, or persons attending the investor conference or investor seminar are informed in writing of, the identity of all parties paying for a portion of the costs of the sales communication, investor conference or investor seminar.

5.2

Mutual Fund Sponsored Conferences - A member of the organization of a mutual fund may 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 members of the organization of the mutual fund, if

- (a) the primary purpose of the conference or seminar is the provision of educational information about financial planning, investing in securities, mutual fund industry matters, the mutual fund, the mutual fund family of which the mutual fund is a member or mutual funds generally;
- (b) the selection of the representatives of the participating dealer to attend the conference or seminar is made exclusively by the participating dealer, uninfluenced by any member of the organization of the mutual fund;
- (c) the conference or seminar is held in
 - (i) Canada,
 - (ii) the continental United States of America, or
 - (iii) 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;
- (d) no member of the organization of the mutual fund pays any travel, accommodation or personal incidental expenses associated with the attendance of the representative at the conference or seminar; and
- (e) the costs relating to the organization and presentation of the conference or seminar are reasonable having regard to the purpose of the conference or seminar.

5.3

Third Party Sponsored Educational Events - A member of the organization of a mutual fund may, for a conference, seminar or course that is organized and presented by a person or company that is not a member of the organization of the mutual fund or a participating dealer, pay the registration fees of a representative of a participating dealer for the conference, seminar or course, if

- (a) the primary purpose of the conference, seminar or course is the provision of educational information about financial planning, investing in securities, mutual fund industry matters or mutual funds generally;
- (b) the participating dealer provides invoices for or receipts evidencing payment of the registration fees to be paid by a member of the organization of the mutual fund;
- (c) the selection of the representatives of the participating dealer to attend the conference, seminar or course is made exclusively by the participating dealer, uninfluenced by any member of the organization of the mutual fund; and
- (d) the conference, seminar or course is held in Canada or the continental United States of America.

5.4

Industry Association Sponsored Events

- (1) Except as permitted by section 5.3 or subsection (2), no member of the organization of a mutual fund may pay money, provide non-monetary benefits or pay or reimburse costs or expenses relating to a conference, seminar or course that is organized and presented by IFIC, the IDA or another trade or industry association.
- (2) A member of the organization of a mutual fund may pay, to IFIC, 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 and presented by IFIC, the IDA or their respective affiliates or associates, if
 - (a) the primary purpose of the conference or seminar is the provision of educational information about financial planning, investing in securities, mutual fund industry matters or mutual funds generally;
 - (b) the members of the organization of mutual funds in a mutual fund family in aggregate pay not more than 10 percent of the total direct costs incurred by IFIC, the IDA or their respective affiliates or associates for the organization and presentation of the conference or seminar;

- (c) the selection of the representatives of a participating dealer to attend the conference or seminar is made exclusively by the participating dealer, uninfluenced by any member of the organization of the mutual fund; and
- (d) the conference or seminar is held in Canada or the continental United States of America.

5.5 Participating Dealer Sponsored Events - A member of the organization of a mutual fund may 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, and that is not an investor conference or investor seminar referred to in section 5.1, if

- (a) the primary purpose of the conference or seminar is the provision of educational information about financial planning, investing in securities, mutual fund industry matters, the mutual fund, the mutual fund family of which the mutual fund is a member or mutual funds generally;
- (b) the members of the organization of mutual funds in a mutual fund family in aggregate pay not more than 10 percent of the total direct costs incurred by the participating dealer for the organization and presentation of the conference or seminar;
- (c) the aggregate direct costs of the conference or seminar paid by all members of organizations of mutual funds do not exceed 66 percent of the total direct costs incurred by the participating dealer;
- (d) the selection of the representatives of the participating dealer to attend the conference or seminar is made exclusively by the participating dealer, uninfluenced by any member of the organization of the mutual fund; and
- (e) the conference or seminar is held in
 - (i) Canada,
 - (ii) the continental United States of America, or
 - (iii) 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.

5.6

Promotional Items and Business Promotion Activities - A member of the organization of a mutual fund may provide to a representative of a participating dealer non-monetary benefits of a promotional nature and of minimal value, and a member of the organization of a mutual fund may engage in business promotion activities that result in a representative of a participating dealer receiving a non-monetary benefit if

- (a) the provision of the benefits and activities is neither so extensive nor so frequent as to cause a reasonable person to question whether the provision of the benefits or activities improperly influence the investment advice given by the representative to his or her clients; and
- (b) in the case of business promotion activities, no member of the organization of the mutual fund pays the travel, accommodation or personal incidental expenses associated with the attendance of the representative at the activities.

PART 6 PORTFOLIO TRANSACTIONS

6.1 Reciprocal Commissions and Portfolio Transactions

- (1) No member of the organization of a mutual fund shall influence or attempt to influence how, or if, a participating dealer will pay or allocate in a particular manner to any representative all or part of a brokerage commission or of an amount representing the spread on a principal transaction arising from a portfolio transaction of the mutual fund executed by the participating dealer.
- (2) No member of the organization of a mutual fund shall direct a portfolio transaction of a mutual fund to a participating dealer or principal distributor of the mutual fund except through individuals designated by the participating dealer or principal distributor as the institutional representatives of the participating dealer or principal distributor.
- (3) No member of the organization of a mutual fund shall advise a representative of a participating dealer or a person or company employed by a principal distributor, other than an individual referred to in subsection (2), of a portfolio transaction of the mutual fund to be directed to the participating dealer or principal distributor.
- (4) No member of the organization of a mutual fund shall direct, or offer or agree to direct, a portfolio transaction of the mutual fund to a participating dealer or principal distributor as inducement or reward for the participating dealer or principal distributor selling or having sold securities of the mutual fund or maintaining or having maintained particular levels of securities of the mutual fund

in accounts of clients.

- (5) No participating dealer shall solicit or execute portfolio transactions of a mutual fund as inducement or reward for the participating dealer selling, or having sold, securities of the mutual fund or maintaining, or having maintained, particular levels of securities of the mutual fund in accounts of clients.

6.2 Obligations of Participating Dealers Executing Portfolio Transactions -No participating dealer shall execute a portfolio transaction of a mutual fund unless it has been directed to the participating dealer through an individual designated by the participating dealer as an institutional representative of the participating dealer.

PART 7 OTHER SALES PRACTICES

7.1 Commission Rebates

- (1) A participating dealer or representative of a participating dealer may pay all or part of a fee or commission payable by a securityholder on the redemption of securities of a mutual fund that occurs in connection with the purchase by the securityholder of securities of a mutual fund in a different mutual fund family, only if
 - (a) the participating dealer, or a representative on behalf of the participating dealer, before taking any steps in connection with the redemption, provides the securityholder with written disclosure of the matters described in subsection (2) and obtains the written consent of the securityholder to the completion of the redemption; and
 - (b) the participating dealer is not a member of the organization of the mutual fund the securities of which are being acquired.
- (2) The written disclosure referred to in subsection (1) shall include
 - (a) a reasonable estimate of the amount of the fee or commission being paid by the participating dealer on the redemption;
 - (b) a reasonable estimate of the amount of the redemption charges to which the securityholder will be subject in connection with the securities of the mutual fund being acquired, expressed both as dollar amounts and as percentages of the value of the securities being redeemed, and the times at which those charges would be made; and

- (c) the tax consequences of the redemption.
- (3) No member of the organization of a mutual fund, other than a member that is also a participating dealer acting in compliance with subsection (1), shall pay to any person or company all or part of a fee or commission payable by a securityholder on the redemption of securities of another mutual fund that is not in the same mutual fund family.

7.2 Financial Assistance

- (1) No member of the organization of a mutual fund shall provide financial assistance to a participating dealer of the mutual fund, a representative of the participating dealer or their respective associates or affiliates.
- (2) No participating dealer and no representative of a participating dealer of a mutual fund shall solicit or accept financial assistance from a member of the organization of the mutual fund.
- (3) Subsections (1) and (2) do not apply to financial assistance provided by
 - (a) a Canadian financial institution in the ordinary course of its business, if no conditions to the provision of the financial assistance promote the distribution of securities of particular mutual funds; or
 - (b) affiliates.

7.3 Charitable Donations

- (1) No member of the organization of a mutual fund shall make a charitable donation if the tax credit or deduction arising from the donation benefits a participating dealer, a representative of a participating dealer or a person or company that is an associate or affiliate of a participating dealer or of a representative of a participating dealer.
- (2) Subsection (1) does not apply to a charitable donation made by a member of the organization of a mutual fund if the tax credit or deduction arising from the donation benefits an affiliate of the member of the organization of the mutual fund.

7.4 Tied Selling - No person or company shall require another person or company

- (a) to invest in securities of a particular mutual fund or mutual fund family, either as a condition or on terms that appear to a reasonable person to be a condition, of supplying or continuing to supply products or services; or

- (b) to purchase or use any products or services, either as a condition or on terms that appear to a reasonable person to be a condition, of selling securities of a particular mutual fund or mutual fund family.

PART 8 PROSPECTUS AND POINT OF SALE DISCLOSURE

8.1 Disclosure of Sales Practices

- (1) A mutual fund shall provide in its prospectus or simplified prospectus a complete description of
 - (a) all compensation payable by members of the organization of the mutual fund to all principal distributors and participating dealers of the mutual fund; and
 - (b) the sales practices followed by the members of the organization of the mutual fund for distribution of securities of the mutual fund.

8.2 Disclosure of Equity Interests

- (1) A mutual fund shall disclose in its prospectus or simplified prospectus the amount of any equity interest that
 - (a) a member of the organization of the mutual fund has in a participating dealer;
 - (b) a participating dealer and associates of the participating dealer, in aggregate, have in any member of the organization of the mutual fund; and
 - (c) a representative of a participating dealer and associates of the representative, in aggregate, have in any member of the organization of the mutual fund.
- (2) If a member of the organization of a mutual fund is not a reporting issuer and the securities of the member are not listed on a Canadian stock exchange, the mutual fund is not required to provide the disclosure required by paragraph (1)(c) if it discloses
 - (a) the aggregate equity interests held by all representatives of a participating dealer and their respective associates in the member of

the organization of the mutual fund; and

- (b) the equity interests held by a representative of a participating dealer and associates of the representative if the representative and his or her associates have direct or indirect ownership of securities representing more than five percent of any class of voting securities, equity securities or partnership units of the member of the organization of the mutual fund.
- (3) For each trade of a security of a mutual fund that is required to make any of the disclosure described in this section, a participating dealer shall deliver to the purchaser a document that discloses the amount of any equity interest that
- (a) a member of the organization of the mutual fund has in the participating dealer;
 - (b) the participating dealer and its associates, in aggregate, have in any member of the organization of the mutual fund;
 - (c) the representatives of the participating dealer and associates of those representatives, in aggregate, have in any member of the organization of the mutual fund; and
 - (d) the representative of the participating dealer that is acting on the trade, and associates of the representative, in aggregate, have in any member of the organization of the mutual fund.
- (4) No participating dealer shall complete a trade to which subsection (3) applies unless the participating dealer obtains the prior written consent of the purchaser to the completion of the trade after the purchaser has received the document required by subsection (3).
- (5) A participating dealer is not required to comply with subsections (3) and (4) for a trade if the purchaser in the trade has already been provided with a document under subsection (3) on a previous trade and the information contained in the document has not changed.

8.3

Disclosure Requirements If No Prospectus or Simplified Prospectus - A mutual fund that does not have a current prospectus or simplified prospectus shall prepare a document containing the information required by this Instrument to be provided in a prospectus or simplified prospectus and deliver, or cause to be delivered, a copy of the document to each purchaser of securities of the mutual fund at or before the time of the applicable trade in securities of the mutual fund, other than a trade in connection with a dividend reinvestment plan of the mutual fund.

PART 9 EXEMPTION

9.1 Exemption

- (1) The regulator or securities regulatory authority may grant an exemption to this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

- (2) Despite subsection (1), in Ontario, only the securities regulatory authority may grant such an exemption.

PART 10 TRANSITIONAL

10.1 Effective Date - This Instrument comes into force on May 1, 1998.

10.2 Prospectus Disclosure - The prospectus of a mutual fund for which a receipt is obtained before the date that this Instrument comes into force is not required to comply with the disclosure requirements of this Instrument.

COMPANION POLICY 81-105CP TO NATIONAL INSTRUMENT 81-105 MUTUAL FUND SALES PRACTICES

PART 1 PURPOSE

1.1 Purpose - The purpose of this Policy is to state the views of the Canadian securities regulatory authorities on various matters relating to National Instrument 81-105 Mutual Fund Sales Practices (the "Instrument"), including

- (a) a discussion of the general approach taken by the Canadian securities regulatory authorities in, and the general regulatory purpose for, the Instrument;
- (b) the interpretation of various terms used in the Instrument; and
- (c) examples of some of the matters described in the Instrument.

PART 2 GENERAL DISCUSSION OF THE INSTRUMENT

2.1 Background

- (1) The Instrument has been adopted by the Canadian securities regulatory authorities as a response to the concern of many participants in the mutual fund industry that the pre-existing regulatory strategy of reliance on prospectus disclosure of sales practices, coupled with the discipline imposed by competitive market forces, were not sufficient to discourage sales practices and compensation arrangements that gave rise to questions as to whether participating dealers and their representatives were being induced to sell mutual fund securities on the basis of the incentives they were receiving as opposed to what was suitable for and in the best interests of their clients.
- (2) Mutual fund sales practices have been of interest and concern to the Canadian securities regulatory authorities and the mutual fund industry for a number of years. In August 1991, The Investment Funds Institute of Canada ("IFIC") issued its report on mutual fund sales incentives (the "1991 IFIC Report"). The 1991 IFIC Report was followed by the release, in October 1991, of the IFIC Code of Conduct (the "1991 IFIC Code") dealing with sales incentives.

The 1991 IFIC Code required enhanced disclosure of sales incentives offered as compensation for sales of mutual fund securities and also required that investors in mutual funds be provided with a separate "point-of-sale" disclosure statement advising investors of the sales incentives applicable to the purchase.

(3) A substantial review of the investment fund industry was undertaken by Ontario Securities Commission ("OSC") Commissioner Glorianne Stromberg at the request of the OSC in February 1994. Her report *"Regulatory Strategies for the Mid-'90s - Recommendations for Regulating Investment Funds in Canada"*, was prepared for the Canadian Securities Administrators ("CSA") and released in January 1995.

(4) Commissioner Stromberg noted in her report that as a result of competitive pressures "questionable sales practices and incentives have become commonplace in the industry". She concluded that the regulatory strategy referred to in subsection (1) above would be an appropriate regulatory strategy if certain recommended fundamental changes were made to the regulation of sales practices.¹

(5) In response to Commissioner Stromberg's report, IFIC, after extensive industry consultation, released its recommendations for a Code of Sales Practices for the Mutual Fund Industry dated March 29, 1996 (the "IFIC Code").² The IFIC Code stated in its preamble:

"The Draft Code is designed to establish the industry standard of conduct and to reflect its concern for investor protection. The sales practices suggested in the Draft Code are designed to align the interests of the principal parties to the transaction, *i.e.* the investor, fund manager and, where applicable, third party fund distributor firm and salesperson, and to encourage long term relationships among them. If implemented, the Draft Code would prohibit many sales practices which could result in conflicts of interest between the interests of an investor and those of the distributor firm, its salespersons and a fund manager. IFIC believes that it is important, in the case of sales practices permitted under the Draft Code, that there be full disclosure of the sales practice in order that an investor is fully informed of the circumstances surrounding investment in mutual funds".

(6) In the absence of a self-regulatory organization which could adopt the IFIC Code as a regulation applicable to all distributors of securities of mutual funds, IFIC recommended that the provisions of the IFIC Code be reflected in rules of the Canadian securities regulatory authorities. This request was endorsed by the Investment Funds Steering Group.³

(7) The Instrument is based on, and in Ontario, is an amended version of, a proposed Ontario rule regarding mutual fund sales practices (the "Ontario Draft Rule") published for comment in Ontario on August 30, 1996 at (1996), 19 OSCB 4734. The Ontario Draft Rule reflected the approach taken in the IFIC Code and also reflected certain of the by-laws and rules of the IDA. This Instrument reflects

the discussions of the Canadian securities regulatory authorities of comments received in Ontario in respect of the Ontario Draft Rule. The Canadian securities regulatory authorities have made the Instrument in order to make mandatory, on an industry-wide basis across Canada, restrictions on certain sales and business practices followed by participants in the mutual fund industry.

2.2 General Purpose of the Instrument

(1) The purpose of the Instrument is to ensure that the interests of investors remain uppermost in the actions of participants in the mutual fund industry by setting minimum standards of conduct to be followed by industry participants in their activities in distributing mutual fund securities. The minimum standards of conduct established by the Instrument are designed to minimize the conflicts between the legitimate commercial goals of industry participants and the fundamental obligations outlined in subsection (2) that are owed by industry participants towards investors.

(2) The Instrument prohibits certain sales practices and compensation arrangements that have developed and that the Canadian securities regulatory authorities consider undermine, compromise or conflict with the following fundamental obligations of industry participants to their investor clients:

- (a) investment recommendations should be made by a representative of a participating dealer to an investor based on the investor's investment objectives and circumstances and must be suitable for that investor;
- (b) a participating dealer and its representatives have a primary obligation to act in the best interests of clients;
- (c) where an investor is relying on a participating dealer and a representative of a participating dealer to provide him or her with independent expertise and advice regarding options for mutual fund or other investments, the participating dealer and the representative of the participating dealer have a fiduciary obligation not to compromise the provision of this expertise and advice;
- (d) a participating dealer, as a registrant under securities legislation, is required to exercise adequate and appropriate supervision of its representatives who are dealing with clients to ensure compliance with all statutory and other legal obligations;
- (e) members of the organization of a mutual fund providing management services to a mutual fund have an obligation to act

honestly, in good faith and in the best interests of the mutual fund and its securityholders; and

- (f) full, true and plain disclosure of all material facts concerning a mutual fund, including the compensation paid to participating dealers and their representatives and other sales practices followed in connection with the distribution of mutual fund securities, is essential to ensure that investors understand the nature of the investments they are making and the impact of fees and charges on them.

(3) The Canadian securities regulatory authorities are aware that other sales practices or compensation arrangements could arise that also undermine or compromise the focus of industry participants in complying with the fundamental obligations outlined in subsection (2). The Canadian securities regulatory authorities expect participants in the mutual fund industry to be and remain faithful to their fundamental obligations to the investing public, and not to allow practices or arrangements to develop that threaten this high standard of conduct. In this context, the restrictions on sales practices articulated by the Instrument should be seen as the minimum standards that should be followed by industry participants in order to fulfil their fundamental obligations.

2.3 Application of the Instrument to Labour-Sponsored Venture Capital Corporations

(1) Labour-sponsored venture capital corporations ("LSVCCs") are investment vehicles existing under the *Income Tax Act* (Canada) and legislation of some jurisdictions. LSVCCs that are structured as mutual funds are regulated as mutual funds in a number of jurisdictions, including Ontario and British Columbia, subject to certain exemptions. LSVCCs are considered not to be mutual funds in Quebec under Quebec securities legislation. LSVCCs are also considered not to be mutual funds in Manitoba; however, the Manitoba Securities Commission has issued a local instrument that makes LSVCCs in Manitoba subject to the Instrument.

(2) The Canadian securities regulatory authorities consider LSVCCs to be subject to the Instrument except in those jurisdictions in which LSVCCs are considered not to be mutual funds, in the case of Quebec, or have specifically been made subject to the Instrument, in the case of Manitoba.

(3) Section 2.1 of the Instrument prohibits a mutual fund from making a payment of money or providing a non-monetary benefit to a participating dealer or a representative of a participating dealer or paying for or making reimbursement of a cost or expense incurred or to be incurred by a participating dealer or representative of a

participating dealer. Under the Instrument, all such payments or actions must be made by members of the organization of a mutual fund, not the mutual fund itself.

(4) Costs relating to the distribution of securities of LSVCCs are currently paid by the LSVCCs themselves for reasons related to the specialized organizational and legal structure of LSVCCs. Therefore, the applicable Canadian securities regulatory authorities will entertain applications from LSVCCs for relief from the provisions of the Instrument that prohibit mutual funds from making the payments or effecting the actions described in section 2.1 of the Instrument. The relief, if granted by the securities regulatory authority in a jurisdiction for an LSVCC, will permit the LSVCC to make those payments or take those actions, subject to all of the other requirements of the Instrument. Under such relief, the LSVCC, for example, would be permitted to pay trailing commissions directly to participating dealers, but subject to the requirements of section 3.2 of the Instrument and any other condition imposed in connection with such relief.

2.4

Indirect Avoidance of the Instrument

(1) The Canadian securities regulatory authorities have in connection with the IFIC Code, on occasion, encountered creative ways in which arrangements have been structured that permit benefits to be provided by a mutual fund organization to a participating dealer in a manner that the Canadian securities authorities would regard as contrary to the clear spirit and intent of the IFIC Code.

(2) The Canadian securities regulatory authorities may examine arrangements that raise the suspicion of being structured to permit a party to do indirectly what it cannot do directly. The Canadian securities regulatory authorities regard the prohibitions contained in the Instrument as prohibitions against both direct and indirect actions in relation to the subject matter of the prohibition.

(3) For example, Part 2 of the Instrument contains the basic prohibitions of the Instrument against members of the organization of a mutual fund making payments, among other things, to participating dealers or their representatives in connection with the distribution of securities of the mutual fund. This provision prohibits both the direct and indirect payment of money from mutual fund organizations to dealers, and the Canadian securities regulatory authorities will not hesitate to look through an arrangement in which, for example, a mutual fund organization paid money to a third party in connection with the distribution of securities of the mutual fund, knowing that the money would flow back to the participating dealer.

(4) It is noted that the draft of the Instrument that was published for comment contained a prohibition against indirect action. The Canadian securities regulatory authorities note that that provision was

deleted from the final version of the Instrument because, as a matter of legislative drafting, it was considered unnecessary to be included in the Instrument. No inference should be taken from the deletion that the principle contained in that provision is inapplicable to the Instrument.

PART 3 DEFINITION OF "REPRESENTATIVE"

3.1 Definition of "representative"

(1) The definition of the term "representative" contained in section 1.1 of the Instrument includes a person who is registered in the category of partner, director, officer or salesperson of a participating dealer, even though the relationship of the person with the participating dealer may be one of independent contractor. The definition of the term "representative" also includes employees of a participating dealer, even if those employees are not registered with the securities regulatory authority.

(2) Paragraph (b) of the definition of "representative" includes personal holding companies of the persons referred to in paragraph (a) of the definition. The Canadian securities regulatory authorities have included this paragraph to ensure that the provisions of the Instrument apply both to the persons who carry on activities through personal holding companies and to the holding companies themselves.

PART 4 DISCUSSION OF CERTAIN ASPECTS OF PART 2 OF THE INSTRUMENT

4.1 The phrase "in connection with the distribution of securities" -

The prohibitions and restrictions contained in sections 2.1 and 2.2 of the Instrument relate to actions taken "in connection with the distribution of securities" of a mutual fund. The Canadian securities regulatory authorities are of the view that this phrase includes, without limitation, any activity done in furtherance of the sale, distribution or marketing of securities of mutual funds. This would include promotional activities relating to the investment in securities or mutual funds generally, or educational activities concerning financial, investment or retirement planning that could involve a discussion of the advantages and disadvantages of mutual fund investments. Any compensation or non-monetary benefits given to solidify or promote a relationship between a member of the organization of a mutual fund and a participating dealer and its representatives would fall within the scope of these sections. The phrase should not be interpreted restrictively or narrowly.

4.2 Non-Monetary Benefits

(1) Part 2 of the Instrument contains restrictions and prohibitions

on the provision of, among other things, non-monetary benefits to participating dealers and their representatives.

(2) The Canadian securities regulatory authorities are of the view that the term "non-monetary benefits" includes any goods, services or other benefits that could be provided to or received by a person or company and that could be perceived by that person as being of benefit, advantage or value to him, her or it. The matters that are included in the term include, without limitation

- (a) domestic or foreign trips, food, beverages and accommodation, regardless of whether these benefits are provided in connection with attendance at a conference or other event sponsored by a member of the organization of a mutual fund;
- (b) entertainment, including the provision of tickets to concerts, theatre or sporting events, or the ability to participate in events such as golf tournaments;
- (c) gifts and non-cash gratuities;
- (d) invitations to educational seminars or conferences organized by members of the organization of a mutual fund;
- (e) attendance at educational seminars, conferences or courses; and
- (f) computer hardware, including networking hardware and general business software systems.

(3) The term "non-monetary benefits" does not include the goods and services that are provided by mutual fund organizations to participating dealers to facilitate the marketing of securities of the mutual fund, such as brochures, educational material, supplies of prospectuses or simplified prospectuses and financial statements.

(4) Some mutual fund organizations provide participating dealers with computer software that is designed to assist in determining which of the mutual funds of the organization are most appropriate for a client of the participating dealer, having regard to the investment objectives and financial condition of the client. The Canadian securities regulatory authorities are of the view that the provision of this type of proprietary software is not a non-monetary benefit to the participating dealer and is in the nature of marketing materials as referred to in subsection (3).

(5) However, the Canadian securities regulatory authorities consider that the provision of financial planning software of a more

general nature, whether proprietary to the mutual fund organization or not, would likely constitute a non-monetary benefit. In addition, other non-proprietary software that is provided to the participating dealer would generally be considered to be a non-monetary benefit.

(6) The provision by a member of the organization of a mutual fund to a participating dealer of computer software, the only purpose of which is to facilitate the electronic interface between the participating dealer and the members of the organization of the mutual fund, is not considered to be included in the term "non-monetary benefits".

4.3 The phrase "pay for or make reimbursement of a cost or expense incurred or to be incurred by a participating dealer or a representative of a participating dealer" - Section 2.1 of the Instrument contains restrictions and prohibitions on the ability of a mutual fund and a member of the organization of a mutual fund to "pay for or make reimbursement of a cost or expense incurred or to be incurred by a participating dealer or a representative of a participating dealer". Section 2.2 contains corresponding restrictions and prohibitions on the ability of a participating dealer and its representatives to solicit or accept such payments. The Canadian securities regulatory authorities are of the view that this phrase includes direct or indirect reimbursement of costs or expenses, any payment that compensates a participating dealer or representative for such costs or expenses or any other method whereby the member of the organization of the mutual fund directly or indirectly bears the costs or expenses incurred.

4.4 Exception for Some Participating Dealers and Representatives

(1) Section 2.3 of the Instrument provides that nothing in the Instrument prohibits a person or company that is both a member of the organization of a mutual fund and a participating dealer of a mutual fund in a different mutual fund family from undertaking any activity, if

(a) the activity is undertaken in the person or company's capacity as a participating dealer of the mutual fund of which it is a participating dealer, and not in its capacity as a member of the organization of the mutual fund of which it is a member; and

(b) a participating dealer is not prohibited by the Instrument from undertaking that activity.

(2) That section is designed to respond to the fact that many registrants that are participating dealers will also be members of organizations of mutual funds; for example, a dealer that is owned by a bank will likely be an affiliate of the manager or principal distributor of a mutual fund sponsored by that bank and thus be a member of the organization of that mutual fund.

(3) The Canadian securities regulatory authorities intend that a participating dealer that is also a member of the organization of a mutual fund will have the freedom to operate as a participating dealer without concern over technically breaching the restrictions on members of the organizations of mutual funds contained in the Instrument. Some examples of how section 2.3 of the Instrument would be relevant to certain actions, assuming that the conditions of section 2.3 were satisfied, are as follows:

(a) a participating dealer that is also a member of the organization of a mutual fund would not be constrained in how it compensates its own representatives or employees by the provisions of Part 2 of the Instrument;

(b) a participating dealer that is also a member of the organization of a mutual fund would not be limited by the operation of section 5.1 of the Instrument in presenting an investor conference by the fact that the dealer may also be a member of the organization of the mutual fund;

(c) section 5.2 of the Instrument would not prevent a participating dealer that is also a member of the organization of a mutual fund from paying the travel, accommodation and personal incidental expenses for its own representatives to attend conferences sponsored by the mutual fund organization; and

(d) section 5.5 of the Instrument would not operate to subject a participating dealer to the limitations contained in that section if the dealer was sponsoring a conference for its own representatives; the dealer would be able to pay for its own costs even though technically, the dealer was a member of the organization of a mutual fund.

(4) Similarly, by reason of subsection 2.3(2), the Instrument will not affect the ability of a representative of a participating dealer that is a member of the organization of a mutual fund to receive compensation otherwise permitted by the Instrument from the participating dealer.

(5) The Canadian securities regulatory authorities note they would consider any action in which the relationship between a mutual fund organization and a participating dealer that was a member of the organization was used in an attempt to avoid the Instrument to be offensive to the Instrument.

5.1 Method of Calculation - Paragraphs 3.1(b) and 3.2(b) of the Instrument require the disclosure of the method of calculation used in determining the amount of sales commissions and trailing commissions. The Canadian securities regulatory authorities are of the view that this requirement will be satisfied with disclosure of a general nature as to how those commissions are calculated; the authorities expect that this disclosure would describe, generally, that the amount of a commission is calculated through multiplying a specified rate of commission by some aggregate dollar amount of securities sold or held as at a specified time.

5.2 Bonus Commissions - Subparagraphs 3.1(c)(iii) and 3.2(1)(d)(iii) of the Instrument prevent the payment of "bonus commissions", in which the rates of commissions paid or earned during a particular period of the year are higher than the rates of commissions paid or earned for any other time. This provision should not be read to prevent a mutual fund from changing its general commission rates at some time during a year. It is noted that in such circumstances, the mutual fund should amend its prospectus or simplified prospectus to disclose the change in general commission rates applicable to sales of its securities.

5.3 Trailing Commission Thresholds

(1) The Canadian securities regulatory authorities note that the IFIC Code permits a mutual fund organization to pay, and a participating dealer to accept, trailing commissions based on the assets in an individual representative's client accounts, on a representative by representative basis. The IFIC Code further provides that a mutual fund organization could establish a payment policy whereby no trailing commission would be paid to a participating dealer in respect of a particular representative if the assets in the representative's client accounts did not exceed \$100,000.

(2) The Canadian securities regulatory authorities consider that the effect of the rules established by subsection 2.1(3) and section 3.2 of the Instrument mean that mutual fund organizations can no longer establish the minimum asset thresholds referred to in the IFIC Code. These sections require that the percentage that a trailing commission represents of the aggregate value of securities of a mutual fund held in accounts of clients of a participating dealer must be the same for that participating dealer, regardless of the aggregate value of securities of the mutual fund in accounts of clients of the participating dealer at any time or the aggregate level of sales of securities of the mutual fund by the participating dealer.

(3) Subsection 3.2(3) of the Instrument provides a limited transitional exception to the general provisions of section 3.2 concerning minimum thresholds in relation to trailing commissions. Subsection 3.2(3) permits a member of the organization of a mutual fund not to pay a trailing commission in respect of securities of the mutual fund

held in accounts of clients of the participating dealer in certain circumstances; namely that the non-payment be consistent with a policy established and followed on July 1, 1997, and that the securities with respect to which no trailing commission is paid must have been acquired by those clients before the date that the Instrument came into force. The rules established by section 3.2 are not intended to retroactively affect existing arrangements between mutual fund organizations and participating dealers respecting securities acquired before the Instrument came into force.

- (4) The following examples are offered to illustrate the operation of subsection 3.2(3) of the Instrument. In each case, assume that a mutual fund organization had in place on July 1, 1997 a policy of not paying trailing commissions in respect of securities held in accounts of clients of a participating dealer, on a representative by representative basis, if the aggregate value of securities in those accounts was less than \$100,000.
 - (a) At some time after the Instrument came into force, securities in client accounts totalled \$75,000 in value, of which \$50,000 were acquired before the Instrument came into force, and \$25,000 were acquired after the Instrument came into force. The mutual fund organization is entitled under the Instrument to decline to pay a trailing commission in respect of the \$50,000 value of securities acquired before the Instrument came into force, but must pay a trailing commission on the \$25,000 value of securities acquired after the Instrument came into force; and
 - (b) At some time after the Instrument came into force, securities in client accounts totalled \$125,000 in value, of which \$50,000 were acquired before the Instrument came into force, and \$75,000 were acquired after the Instrument came into force. The mutual fund organization is required to pay trailing commissions on the \$75,000 worth of the securities acquired after the Instrument came into force. Also, since the \$100,000 threshold established under the policy of the organization in place on July 1, 1997 was exceeded, the mutual fund organization would pay a trailing commission on all \$125,000 value of securities held in the accounts.
- (5) The Canadian securities regulatory authorities note that mutual fund organizations are not required to continue to maintain those policies of not paying trailing commissions in the circumstances described in subsections (3) and (4). As provided in paragraph 3.2(3)(c) of the Instrument, any non-payment of a trailing commission under section 3.2 must be in conformity with the pre-established policy of the mutual fund organization.

- (6) The Instrument is intended to remove the conflicts inherent in representatives seeking to achieve specific asset and sales thresholds in order to receive compensation in respect of mutual fund sales. An internal compensation system of a participating dealer whereby a representative is not paid any portion of a commission that is less than a specified dollar amount could be viewed as imposing indirectly an asset and sales threshold for that representative. The Canadian securities regulatory authorities are concerned that the internal compensation systems of participating dealers not 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.
- (7) The Canadian securities regulatory authorities have received questions as to whether a mutual fund organization is required to pay the same rate of commission, inclusive of trailing commissions, to all participating dealers that sell the securities of the mutual fund organization's mutual fund family. The Canadian securities regulatory authorities note that the Instrument does not require the same rate of commission to be paid. However, the Canadian securities regulatory authorities would consider that the rules set out in Part 3 of the Instrument prohibiting mutual fund organizations from setting minimum asset and sales thresholds in respect of commission payments would be offended if a mutual fund organization established a practice of only paying participating dealers commissions, or higher rates of commissions, if these dealers met a specified asset or sales threshold.

PART 6 INTERNAL DEALER INCENTIVE PRACTICES

- 6.1 Internal Dealer Incentive Practices** - Sections 4.1 and 4.2 of the Instrument permit different payments to be made by participating dealers to their representatives for different mutual funds if the difference in payments is a result of the different commissions received by the dealer from mutual fund organizations. The Canadian securities regulatory authorities recognize that different mutual fund organizations may pay different levels of commissions to dealers and that there is no compelling reason to prevent those differentials from flowing through to the representatives.

PART 7 MARKETING AND EDUCATIONAL PRACTICES

7.1 Definition of "direct costs"

- (1) The phrase "out-of-pocket" costs and expenses, used in the definition of "direct costs" contained in section 1.1 of the Instrument, does not include internal salary and overhead costs associated with the efforts of the participating dealer relating to the applicable sales communication or event. The definition of "direct costs" specifically

excludes any costs incurred by a participating dealer for travel, accommodation or personal incidental expenses associated with the attendance of individuals at applicable events. The Canadian securities regulatory authorities are of the view that those types of expenses form part of the cost of doing business for the participating dealer and may not be borne by mutual fund organizations.

(2) Part 5 of the Instrument permits a member of the organization of a mutual fund to pay direct costs incurred by a participating dealer relating to certain sales communications or events on the conditions indicated, which include, in some circumstances, a condition that the participating dealer provide invoices or receipts for the costs to be paid by the member. The Canadian securities regulatory authorities expect members of organizations of mutual funds to exercise reasonable diligence to ensure that the direct costs indicated on invoices or receipts received from participating dealers represent direct costs that are reasonable in the circumstances. The Canadian securities regulatory authorities also expect participating dealers to exercise reasonable diligence to ensure that the direct costs indicated on invoices or receipts delivered to members of organizations of mutual funds represent direct costs incurred by the participating dealer.

7.2 Cooperative Marketing Practices

- (1) Section 5.1 of the Instrument is designed to permit some cooperative marketing between mutual fund organizations and participating dealers, within the parameters set out in that section. The Canadian securities regulatory authorities are aware that participating dealers conduct certain marketing on behalf of mutual fund organizations and accordingly have permitted a limited sharing of the costs of sales communications and investor conferences and seminars that are organized and presented by participating dealers on the conditions contained in section 5.1. Section 5.1, however, does not permit a participating dealer to receive compensation or reimbursement from a mutual fund organization for its general marketing expenses, such as, for example, costs associated with client appreciation events or general client mailings or sales communications that relate generally to the business or operations of the participating dealer. Those costs may not be borne by mutual fund organizations.
- (2) Paragraph 5.1(c) of the Instrument requires a participating dealer to provide invoices for, or receipts evidencing payment of, the direct costs permitted under section 5.1 to be paid by a member of the organization of the mutual fund. The Canadian securities regulatory authorities are of the view that a participating dealer may establish procedures to facilitate the efficient payment or reimbursement of these costs, and note the following in that regard.

(a) It is not necessary that the reimbursement of these costs be processed by the head office of a participating dealer; participating dealers may deal with mutual fund organizations at an appropriately local office level. However, the Canadian securities regulatory authorities emphasize that the Instrument makes a distinction between actions taken by a "participating dealer" and by a "representative". Paragraph 5.1(c) of the Instrument requires a participating dealer to provide the invoices and receipts to the mutual fund organization, and this action cannot be taken directly by representatives of the participating dealer;

(b) The Canadian securities regulatory authorities would not object to participating dealers directing mutual fund organizations to pay suppliers or service providers directly, so long as the payment is otherwise permitted to be made under section 5.1 of the Instrument. There is no need for the mutual fund organization to pay the participating dealer the relevant amount of the costs, who then must pay the supplier.

(3) Paragraph 5.1(e) of the Instrument requires written disclosure of the identity of the parties paying for a portion of the costs of a sales communication, investor conference or investor seminar. The Canadian securities regulatory authorities consider that this disclosure should be in sufficient detail to make clear that a clearly-identified party has paid a portion of the costs. As a result, the mere display of a party's logo would be considered insufficient disclosure both because the display may not adequately identify the party or make clear that the party has paid some of the costs of the event.

7.3

Mutual Fund Sponsored Conferences

- (1) Section 5.2 of the Instrument requires that the costs relating to the organization and presentation of a conference or seminar described in that section be reasonable, having regard to the purpose of the conference or seminar. The Canadian securities regulatory authorities are of the view that "reasonable" costs in this context could include the provision of food and beverages for attendees at the conference or seminar, the provision of conference or seminar materials and the payment or waiver of registration fees at the conference or seminar. The term "reasonable" costs would not include gifts or entertainment provided to attendees other than as permitted by section 5.6 of the Instrument.
- (2) Section 5.2 of the Instrument requires that the selection of the representatives of a participating dealer to attend a mutual fund sponsored conference or seminar is to be made exclusively by the participating dealer, uninfluenced by the mutual fund organization. The Canadian securities regulatory authorities note that the restriction does not prevent mutual fund organizations from organizing events

that are tailored to the interests of particular categories of representatives, and advising the participating dealers of the nature of those events. So, for instance, a mutual fund organization would be free to organize events designed for junior representatives in which entry-level information concerning mutual funds was provided; the organization could advise the participating dealers that it would be appropriate that junior representatives attend. Identifying specific representatives would not constitute compliance with section 5.2 of the Instrument.

7.4 Third Party Sponsored Educational Events - Section 5.3 of the Instrument permits a member of the organization of a mutual fund to pay the registration fees of a representative of a participating dealer for a third party sponsored educational event referred to in that section. The term "registration fees" should be read with its ordinary meaning and should not be read to include travel, accommodation or other incidental costs associated with the attendance of the representative at the event.

7.5 Meaning of "Location" - Subparagraphs 5.2(c)(iii) and 5.5(e)(iii) of the Instrument permit the events to which sections 5.2 and 5.5 apply to take place in a location where a portfolio adviser of a mutual fund carries on business, subject to the condition contained in these subparagraphs. The Canadian securities regulatory authorities note that the term "location" will be interpreted by them to mean the city or immediate locale where the portfolio adviser carries on business. The Canadian securities authorities will regard as abusive any attempt to construe the term "location" in an excessively wide manner. So, for example, for a portfolio adviser carrying on business from an office in London, England, "location" means London or the immediate vicinity; it does not mean England, the British Isles or Europe.

7.6 Promotional Items and Business Promotion Activities

- (1) Section 5.6 of the Instrument permits the provision of "non-monetary benefits of a promotional nature" of minimal value. Examples of this type of benefit include reminder advertising such as pens, calendars, t-shirts, hats, coffee mugs, paperweights and golf balls.
- (2) Section 5.6 of the Instrument permits a member of the organization of a mutual fund family to engage in reasonable business promotion activities. Examples of such activities include occasional meals or drinks, tickets to sporting events, concerts or the theatre or the ability to participate in events such as golf tournaments and other comparable entertainment.

PART 8 RECIPROCAL COMMISSIONS AND PORTFOLIO TRANSACTIONS

8.1 Reciprocal Commissions and Portfolio Transactions

- (1) Part 6 of the Instrument is designed to ensure that "best execution" practices are followed in making brokerage arrangements for mutual funds. It limits the connection between a participating dealer's distribution activities in respect of a mutual fund and its activities in carrying out portfolio transactions for the mutual fund. In this regard, subsection 6.1(2) and section 6.2 of the Instrument require that portfolio transactions for a mutual fund are to be carried out only through a representative of a participating dealer who has been designated as an institutional representative by that participating dealer. The Canadian securities regulatory authorities expect that industry participants will not attempt to circumvent the intent of the Instrument by designating persons as institutional representatives to undertake portfolio transactions for mutual fund organizations if those persons have little or no other dealings with institutional accounts.
- (2) The Canadian securities regulatory authorities recognize that certain types of information sharing between a member of the organization of a mutual fund and a participating dealer or a principal distributor are legitimate. For example, disclosure of trading history to a participating dealer while negotiating commission rates for future trades would not offend subsection 6.1(3) of the Instrument.

PART 9 OTHER SALES PRACTICES

9.1 Commission Rebates - Subsection 7.1(2) of the Instrument requires disclosure of the tax consequences of a redemption. The Canadian securities regulatory authorities expect that this disclosure will be of a general nature, showing the tax effects of a redemption for taxpayers at different marginal rates.

9.2 Tied Selling

- (1) The Canadian securities regulatory authorities note that the "products or services" referred to in paragraph 7.4(b) of the Instrument include the opening of an account.
- (2) The Canadian securities regulatory authorities made section 7.4 of the Instrument in response to a similar provision in the IFIC Code, but also as a result of their concern that certain industry participants could use their ability to provide services (such as making loans) to investors and use undue influence to require or otherwise improperly require or coerce such investors to acquire mutual fund securities as a condition of providing these services. The Canadian securities regulatory authorities are aware that certain industry participants offer financial incentives or advantages to certain clients; the practice of offering these financial incentives or advantages is commonly referred to as "relationship pricing". Section 7.4 is not intended to prohibit so-called

"relationship pricing" or other beneficial selling arrangements similar to relationship pricing. For example, the Canadian securities regulatory authorities would consider that section 7.4 was not offended if a financial institution offered to make a loan to a customer on more favourable terms or conditions than the financial institution would otherwise offer to the customer, if as a condition to obtaining the favourable terms or conditions, the customer acquired securities of mutual funds sponsored by the financial institution. Section 7.4 would be offended, however, if the financial institution refused to make a loan to that customer unless the customer acquired securities of mutual funds sponsored by the financial institution in circumstances, for example, where the customer otherwise met the financial institution's criteria for making loans.

PART 10 DISCLOSURE REQUIREMENTS

10.1 Disclosure of Equity Interests - Section 8.2 of the Instrument requires a mutual fund to disclose equity interests held by participating dealers and their representatives in members of the organization of the mutual fund. The Canadian securities regulatory authorities note that the term "equity interest" is a defined term 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. For example, for a member of an organization that is a reporting issuer whose securities are listed on a Canadian stock exchange, the threshold for disclosure of an equity holding by a participating dealer or a representative of a participating dealer is 10 percent of any class of securities of that member. The Canadian securities regulatory authorities expect the mutual fund to use its reasonable best efforts to seek the relevant information from a member of the organization of the mutual fund that is a reporting issuer whose securities are listed on a Canadian stock exchange. The Canadian securities regulatory authorities would not object to a mutual fund organization disclosing that the information disclosed in the prospectus is to the best of its knowledge.

10.2 Disclosure Requirements - Section 8.3 of the Instrument sets out the disclosure requirements for distributions of securities of a mutual fund subject to the Instrument that are made under an exemption from the prospectus requirements of the securities legislation and in circumstances in which the mutual fund does not have a current prospectus or simplified prospectus available to be delivered to the purchaser of the securities of the mutual fund.

PART 11 EXEMPTIONS

11.1 Exemptions

(1) The procedure to obtain, in more than one jurisdiction, an exemption from the Instrument is as follows:

- (a) the applicant should file an application in writing simultaneously in all jurisdictions in which it requires an exemption;
 - (b) the application should indicate the name of the principal jurisdiction selected by the applicant for the purpose of dealing with the application and, if applicable, any related prospectus filing and of each other jurisdiction where the application and, if applicable, a related prospectus is being filed;
 - (c) the Canadian securities regulatory authority of the principal jurisdiction or the regulator in the principal jurisdiction will, on behalf of the applicant, contact the Canadian securities regulatory authorities or regulators in the other jurisdictions in which the application has been made for their comments concerning the application and will forward all comments to the issuer; and
 - (d) the applicant should respond in writing to all comments to the Canadian securities regulatory authority in the principal jurisdiction, which will forward the response to the Canadian securities regulatory authorities in the other jurisdictions and again coordinate comments.
- (2) In order to enable the Canadian securities regulatory authorities to deal with applications on a timely basis, issuers are encouraged to file applications simultaneously in all jurisdictions in which they require an approval or an exemption.

**COMPANION POLICY 81-105CP TO NATIONAL INSTRUMENT 81-105
MUTUAL FUND SALES PRACTICES
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