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August 23, 2013

Via email

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of
Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New
Brunswick)
Superintendent of Securities, Department of Justice and
Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sirs/Mesdames:

Re: Modernization of Investment Fund Product Regulation (Phase 2)

We submit the following comments in response to the Notice and Request for Comments (the "**Notice**") regarding proposed amendments to National Instrument 81-102 *Mutual Funds* ("**NI 81-102**") Companion Policy 81-102CP Mutual Funds and Related Consequential Amendments and Other Matters Concerning National Instrument 81-104 *Commodity Pools* and Securities Lending, Repurchases and Reverse Repurchases by Investment Funds under the Modernization of Investment Fund Product Regulation (Phase 2) published by the Canadian Securities Administrators (the "**CSA**") on March 27, 2013 ((2013), 36 OSCB Supp-3) ("**Phase 2**"), as amended by CSA Staff Notice 11-324 published on June 27, 2013 ((2013), 36 OSCB 6424) (the "**Extension Notice**"). Thank you for the opportunity to comment on the proposed amendments.

This letter represents the general comments of certain individual members of our securities practice group (and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

We have responded below in Section 1 to the specific questions posed in Annexes A through C of the Notice. In Section 2, we have set out additional comments on specific amendments proposed to NI 81-102. Defined terms used in this letter that are not defined have the meanings ascribed to them in the Notice.

With respect to issues highlighted in the Extension Notice as being a matter of priority, our comments with respect to investment restrictions and parameters, organizational costs, conflict of interest provisions, securityholder and regulatory approval requirements, custodianship requirements, sales and redemptions of securities of non-redeemable investment funds, the commingling of cash and securityholder record requirements are set out in the answers to the applicable questions in Section 1 of our letter as well as in our comments on specific amendments proposed to NI 81-102 in Section 2 of our letter.

We have no comments on the proposed amendments relating to the remaining issues highlighted in the Extension Notice, being record date requirements and sales communications parameters.

As a general preface to our comments, we wish to underscore that any consideration of additional or new restrictions for closed-end or non-redeemable investment funds must be made in light of the fundamental difference between such funds and mutual funds that are redeemable on demand with reference to net asset value ("**NAV**"). This NAV redemption feature is one of the key characteristics of mutual funds and among the primary differentiators for investors when seeking investments suited to their particular investment goals. The Notice of Amendments to NI 81-102 Mutual Funds, Companion Policy 81-102CP, NI 81-106 Investment Fund Continuous Disclosure, NI 81-101 Mutual Fund Prospectus

Disclosure and NI 41-101 General Prospectus Requirements published on February 10, 2012 ((2012), 35 OSCB 1375) states at p. 1376 that "[t]he objective of the second phase of the Modernization Project is to identify and address any market efficiency, investor protection or fairness issues that arise out of the differing regulatory regimes that apply to different types of publicly offered investment funds. With a view to achieving fair and consistent product regulation across the retail investment fund spectrum, the CSA intend to propose new restrictions and operational requirements for non-redeemable investment funds (such as closed-end funds), that are similar to existing requirements for mutual funds and ETFs under NI 81-102." In our view, "consistent product regulation" is not necessarily a desirable or required outcome given the fundamental difference between mutual funds and non-redeemable investment funds. To impose requirements similar to those applicable to mutual funds without regard to the fundamental difference between them would, we submit, unnecessarily and undesirably constrain market innovation and investor choice.

The history of mutual fund regulation in Canada reflects this fundamental difference and the need for greater flexibility with respect to the regulation of non-redeemable investment funds. For example, when National Policy No. 39 (which is the predecessor to NI 81-102) was first proposed to be replaced by NI 81-102 in 1997, in the related notice and request for comments the CSA stated as follows:

> "Regulation of mutual funds by Canadian securities regulatory authorities has resulted <u>from the primary regulatory need to ensure that the key feature of mutual funds is achieved; that is, the right of investors to redeem securities on demand</u>. Other constraints have been deemed necessary due to the public distribution of such investment vehicles. The authors of a commentary on a proposed federal mutual fund statute published in 1974 described the rationale (which is equally relevant in 1997) for mutual fund regulation of the nature provided for in NP 39 and proposed by the proposed National Instrument, as follows:
>
> > "Constraints inherent in the mutual fund form of organization result largely from the availability of the right to redeem which is the key attribute of a mutual fund. This right dictates constraints to avoid investments that would result in portfolios which could not be precisely valued or would be so illiquid as to make the redemption right unrealistic. This necessity of liquidity accentuates the need which exists with any financial intermediary to prevent misuse of assets. The fact that shares of most mutual funds are in the course of continuous public distribution requires special regulation of the sales function. Constraints inherent in the nature of the market to which mutual funds have historically made their greatest appeal include the necessity of rules to prevent the investor who looks on the mutual fund as a long term savings vehicle from being subject to the risks of an unusual or highly leveraged investment portfolio. However, if possible, the rules should be so formulated as not to prevent the organization

> of mutual funds with distinctive investment objectives designed to appeal to classes of investors with distinctive wishes or requirements."[emphasis added][1]

We also note that non-redeemable investment funds were designed to be different than mutual funds and to provide investors with investment options not available in a mutual fund. Non-redeemable investment funds are also distributed differently than mutual funds. They are prepared by way of long form prospectus with detailed disclosure relating to investment strategy and restrictions, description of the indicative portfolio, description of the sector in which the fund invests and, in most cases, an initial or target distribution and how that distribution will be attained (i.e. through sufficient income generated by the portfolio or through portfolio appreciation). The prospectus is signed by all of the investment dealers who act as agents in the offering and who therefore have prospectus liability for the disclosure contained therein. All of the investment dealers conduct thorough due diligence and have risk and approval processes through which non-redeemable investment fund offerings are vetted by experienced market professionals. In addition to the viability of the investment strategy, issues such as disclosure, risk and suitability, the use of leverage and the ability to pay indicated distributions are carefully scrutinized by the investment dealer syndicate. As a result of these processes, over time a number of best practices have developed that have been imposed by the investment dealers and followed by the industry, including a 1.5% cap on offering expenses payable by the fund, a $20 million minimum offering size for listed non-redeemable investment funds, annual redemption rights at NAV and a common set or approach to investment restrictions, including caps on leverage, concentration and the use of derivatives, that are determined and vetted having regard to asset class and investment strategy.

While we understand that market innovation may necessitate the need to revisit the regulatory approach from time to time, in our view, such innovation has not given rise to concerns that justify the elimination of this fundamentally different approach to regulation between mutual funds and non-redeemable investment funds. It is not obvious that the CSA needs to adopt standards from other, quite different, capital markets in lieu of pursuing a made in Canada framework. Given what we believe to be a well-functioning non-redeemable investment fund market, to the extent there is evidence of specific investor protection concerns, such concerns should be first addressed through the regulation of disclosure. Absent evidence of abuse or mischief, full, true and plain disclosure should be the appropriate avenue for providing investors with the necessary information they need to judge the relevant investment merits and risks associated with any particular fund, including with respect to issues such as investment restrictions and leverage. In this manner, investor protection is fostered while not unduly fettering investor choice and market innovation.

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[1] Notice of Proposed National Instrument 81-102 and Companion Policy 81-102CP and Proposed Rescission of National Policy Statement No. 34 and National Policy Statement No. 39 - Mutual Funds ((1997)) 20 OSCB (Supp 2) published on June 27, 1997 at p. 4, quoting from Warren M.H. Grover and James C. Baillie "*Proposals for a Mutual Fund Law for Canada*" Volume 1 Commentary, Consumer and Corporate Affairs Canada, 1974 (the "**1974 Mutual Fund Report**") at page 5.

We urge the CSA to focus on these principles when considering the application of mutual fund rules and restrictions to non-redeemable investment funds.

The Phase 2 proposals are extensive, encompassing most of NI 81-102 and putting the entirety of regulation of non-redeemable investment funds "into play", initially on 90 days' notice. The Phase 2 proposals extend well beyond the issues that were identified two years ago in Staff Notice 81-322. In this context, the two-month extension of the comment period, granted on the basis of a written request from a significant number of market participants, is not a substitute for robust and meaningful consultation and the more collaborative approach taken by the CSA in other recent regulatory initiatives, such as the examination of mutual fund fees.

Certain of the Phase 2 proposals, including those relating to the introduction of investment restrictions, the requirement for a manager to bear the costs of organizing a new non-redeemable investment fund and additional proficiency requirements for the sale of "alternative fund" securities, represent fundamental and potentially adverse changes to the on-going business and affairs of existing non-redeemable investment funds as well as the manufacture and distribution of securities of new non-redeemable investment funds in Canada. Each of these proposals, but the last two in particular, will act as significant barriers to entry and impose serious impediments to the distribution of the securities of non-redeemable investment funds. Any change of such magnitude must be undertaken only with utmost care, subject to the appropriate analysis as set out in the *Ainsley* decision.[2] In particular, we submit that the following fundamental principle of the OSC in pursuing the purposes of the *Securities Act* (Ontario) should be a key tenet of the CSA in Phase 2: "[b]usiness and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized."[3]

The Notice is not clear on the regulatory objectives sought to be realized and in the absence of any economic or regulatory impact analysis, the CSA have not provided evidence that the restrictions proposed by Phase 2 and costs associated therewith are proportionate to such aims.

As indicated in the Extension Notice, certain aspects of the Phase 2 proposals have been prioritized while others will be subject to further consideration. In this respect, we strongly urge the CSA to adopt a process that allows for adequate consultation and review of the more significant changes that are proposed for investment funds (as highlighted above) and the redesign of the alternative fund framework generally. In our view, these issues would most appropriately be subject to a consultation paper as opposed to proposed regulation, given the limited nature of comment and review that can be undertaken in response to proposed regulation. Such a process would be consistent with the treatment by the CSA of other proposals of similar magnitude, including the CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees published by the CSA on December 13,

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[2] *Ainsley Financial Corp v. Ontario Securities Commission* (1994), 21 O.R. (3d) 104 (C.A.) affirming (1993), 14 O.R. (3d) 280 (Gen. Div.).

[3] *Securities Act*, R.S.O. 1990, c. S.5, s. 2.1(6).

2013 ((2012), 35 OSCB 11233) and the related CSA round table discussion held on June 7, 2013; OSC Staff Consultation Paper 45-710 Considerations For New Capital Raising Prospectus Exemptions and the related consultation sessions undertaken in connection the OSC Exempt Market Review, and the CSA's Derivatives Committee Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada published on November 2, 2010.

On the basis of such precedent, we also strongly encourage the CSA to publish a revised NI 81-102 for further review and comment.

SECTION 1 – RESPONSES TO SPECIFIC QUESTIONS RAISED IN THE NOTICE

ANNEX A - SPECIFIC QUESTIONS OF THE CSA RELATING TO THE PROPOSED 81-102 AMENDMENTS

Annual Redemptions of Securities Based on NAV

1. *Securities legislation defines a "mutual fund" as, among other things, an issuer whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest of the net assets of the issuer.*

   The CSA have historically taken the view that "on demand, or within a specified period after demand" in the definition of "mutual fund" means that the securities of the fund entitle the holders to request that their securities be redeemed by the fund more frequently than once a year. This view has permitted investment funds to redeem their securities once a year based on their NAV and still be considered non-redeemable investment funds. We seek feedback on whether the CSA should reconsider its present view and consider an investment fund to be a mutual fund if it offers any redemptions based on NAV.

   We agree with the current administrative practice. We do not see any reason for the CSA to reconsider its current view that an investment fund may redeem its securities based on NAV once per year and still be considered a "non-redeemable investment fund". However, this interpretation practice is not well-documented and we urge the CSA to express a clear test that is transparent and consistently described and applied. See for example the difference in terminology in footnote 7 at page 4 of the Notice as compared to paragraph (x) on page 9 of the Notice. Footnote 7 refers to redemptions "based on NAV less frequently than once per year" whereas paragraph (x) on page 9 refers first to "annual redemptions based on NAV" and then to "redemptions based on NAV no more than once per year."

Investment Restrictions

Concentration Restriction

2. *Do you agree with the 10% issuer concentration restriction for non-redeemable investment funds set out in proposed amended section 2.1 of NI 81-102? If not, please provide reasons why non-redeemable investment funds should be permitted to have a higher concentration*

limit, and how non-redeemable investment funds would benefit from a higher limit. Please also propose a higher limit and provide reasons for the limit.

If NI 81-102 provides for a concentration limit that is greater than 10% for non-redeemable investment funds, should NI 81-104 provide an even higher concentration limit for non-redeemable investment funds that are alternative funds subject to NI 81-104? Or should the concentration limits be the same for non-redeemable investment funds in both NI 81-102 and NI 81-104? We invite feedback on the appropriate balance of the concentration limit in NI 81-102 for non-redeemable investment funds and the concentration limit for non-redeemable investment funds under the alternative funds framework in NI 81-104.

There are numerous existing types of non-redeemable investment funds that are structured to provide concentrated exposure. Unlike mutual funds, non-redeemable investment funds are redeemable at NAV not more than once per year and they have redemption notice periods that are set sufficiently in advance of the relevant redemption date to permit the portfolio manager to manage the portfolio to provide the necessary liquidity. As such, the concern that a non-redeemable fund will not have the ability to make a NAV redemption payment when required is mitigated and we do not think that a concentration restriction is necessary.

In discussing the difference between conventional and non-conventional funds, the 1974 Mutual Fund Report underscores that investment restrictions would differ between conventional and non-conventional mutual funds in the following manner:

> "If clearly specified in the stated investment practices a non-conventional fund would be able to engage in usual market transactions such as short sales and purchase of puts and calls written by others. Such investments, while perhaps having a greater risk component, will not cause liquidity or valuation problems for non-conventional funds, which we regard as the major reasons for restrictions on investment."[4]

While there may be a view that a concentration restriction is required from an investor protection perspective, in our view there is no direct correlation with any risk to investors where only operational liquidity is required. It is particularly not relevant for funds that are not redeemable, such as flow-through limited partnerships, which have the investment objective of providing returns through tax-assisted investments in "flow-through" shares issued by resource companies ("**Flow-Through Funds**").

Examples of non-redeemable investment funds that have concentrated exposures include funds with subsidiaries, split share corporations that may have exposure to a single counterparty or underlying asset, "two-tier" funds where a "top fund" may have exposure to a single counterparty under a derivative, funds that obtain similar exposures using total return swaps and Flow-Through Funds. With respect to non-redeemable investment funds that are "top funds", the imposition of a concentration

[4] 1974 Mutual Fund Report at pp. 28-29.

restriction could cause a fund to have to terminate its forward arrangements prematurely, thereby triggering unnecessary tax consequences for investors.

“Top funds” have used forward agreements to obtain exposure to underlying funds. Although changes to the Canadian federal income tax consequences of these forward structures have recently been announced, many of these forward structures will be grandfathered from a tax perspective for a number of years until their specified termination dates. If a 10% or higher issuer concentration restriction is imposed on non-redeemable investment funds (or the similar restriction for specified derivatives found in s.2.7(4) of the proposed amendments to NI 81-102 is imposed on them), non-redeemable investment funds using a forward structure (whether using a prepaid or conventional forward) will likely find themselves offside the new restriction if they do not terminate their forward arrangements. This could trigger unnecessary tax consequences for investors.

The manner in which non-redeemable investment funds are brought to market and distributed also cannot be overlooked. The structure is thoroughly scrutinized in the process of an initial public offering under a long form prospectus that is subject to vetting and due diligence by registered investment dealers who have prospectus liability. Fund units are distributed by registered investment dealers who are subject to KYC, suitability and other obligations. The fact that many non-redeemable investment funds are subject to the same types of investment restrictions being proposed under Phase 2 demonstrates that the market is efficient in imposing its own discipline (with the consequence that a range of products/offerings come to market to suit a range of investment needs). In the course of this scrutiny, investment restrictions are tailored having regard to the particular investment objectives, investment strategies and asset classes to ensure that appropriate restrictions have been imposed. This process (which involves the issuer, issuer’s counsel, the lead investment dealer acting as agent and its counsel, as well as vetting by the entire syndicate of investment dealers) results in a dynamic set of restrictions that are designed specifically for each fund. Imposing standardized restrictions on products that are not designed to have the same investment objectives and strategies and that invest in different asset classes would only result in limiting the range of available choices without concomitant proof that such a limitation is necessary or desirable.

As stated above, while we do not agree that a concentration restriction is required, if one is imposed, NI 81-104 should provide for an alternative regime with no concentration limit. In our view, NI 81-104 should provide a fully “alternative” regime, and therefore no concentration restriction should be imposed in order to preserve the *status quo.* As stated in response to other comments in this letter, NI 81-104 should permit a wide range of investment strategies so as not to limit the current choices available to investors. In the event that a concentration restriction is introduced for non-redeemable investment funds, existing funds should be grandfathered indefinitely from any such restriction.

A concentration restriction should also not be imposed prior to having an alternative regime in place under NI 81-104. In this respect, we note that this comment is applicable throughout our comment letter. It is difficult to comment in many respects on proposed amendments to NI 81-102 without knowing what would be available under the alternative regime. We urge the CSA to ensure that there is an additional comment period to allow for further review and comment on any proposed amendments to NI 81-102 after proposed amendments to NI 81-104 have been published. It is difficult to comment on NI 81-102 without knowing what will be proposed for NI 81-104 and pursuing complimentary regimes in isolation will not be the most efficient course and almost certainly will have unintended consequences.

Investments in Illiquid Assets

3. *As non-redeemable investment funds do not redeem their securities regularly based on NAV, the CSA propose that they be permitted to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of NI 81-102.*

However, we are concerned that a portfolio containing a significant amount of illiquid assets could lead to difficulties in valuing the NAV of the fund. It is critical that the NAV of an investment fund be accurately valued; for example, non-redeemable investment funds typically pay management and other fees based on the NAV of the fund, NAV is used to measure performance, and many non-redeemable investment funds offer annual redemptions based on NAV.

We have observed that many non-redeemable investment funds do not invest in a substantial amount of illiquid assets; in fact, the majority of non-redeemable investment funds, like mutual funds, hold minimal amounts of illiquid assets. Would the ability to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of NI 81-102 be beneficial for non-redeemable investment funds? What types of illiquid assets do non-redeemable investment funds wish to invest in, and why?

The CSA invite comment on the amount of illiquid assets that would be appropriate for non-redeemable investment funds to purchase and hold, and whether non-redeemable investment funds should be given more time than 90 days to divest illiquid assets (please refer to the mutual fund divestment requirements in subsections 2.4(2) and (3) of NI 81-102). Is there a minimum amount of liquid assets that non-redeemable investment funds should be required to hold to meet ongoing liquidity needs (e.g., to pay management fees and operational expenses)? Should the limit on illiquid asset investments be different for nonredeemable investment funds that do not offer any redemptions and non-redeemable investment funds that offer annual redemptions?

We do not agree with any restriction on the purchase and holding of illiquid assets. We also refer to our response to Question 2 above and reiterate that any restriction on the purchasing and holding of illiquid assets is also directly relevant to the need for liquidity to fund (daily) redemptions at NAV. It is, therefore, of little relevance or concern where the non-redeemable investment fund has limited redemptions and of no relevance or concern where the fund is not redeemable.

This rationale is most aptly explained in the 1974 Mutual Fund Report as follows:

> "The benchmark of a mutual fund is the liquidity of its investment to the mutual fund shareholder – the investor is entitled to demand redemption of his shares at any time. To ensure that this right remains more than illusory, it is essential that the portfolio investments be highly liquid. Secondly, the holder is interested in receiving a fair price on redemption and on entry so readily evaluable assets are the only ones appropriate for portfolio investment."[5]

While we agree that a fund should generally maintain a reasonable level of liquid assets necessary to fund redemptions, the determination of what is reasonable will differ from fund to fund and, therefore, should not be imposed under a standard regulatory threshold.

Moreover, with respect to difficulties in valuing NAV, we agree with the position outlined by the ICMA Asset Management and Investors Council ("**AMIC**") in its response[6] to the International Organization of Securities Commissions ("**IOSCO**") Consultation Report on Intermediary Internal Controls Associated with Price Verification of Structured Finance Products and Regulatory Approaches to Liquidity Risk Management.[7] The AMIC response recommends that a fund should have a formalized valuation governance arrangement including a formal valuation policy detailing valuation practices, procedures and controls and that valuation could be outsourced to a third party. We think this combination of disclosure and controls would be the more appropriate manner for dealing with NAV valuation issues.

Valuation of NAV is typically carried out by third party service providers based on accounting standards (and not by managers). To the extent there are any valuation complexities that arise, they should be resolved based on accounting standards and relevant policies and assumptions, etc., as permitted by such standards. As underscored by the discussion we highlight from the 1974 Mutual Funds Report above in response to Question 2 above, it also cannot be overlooked that valuation is closely tied to redemption on demand.

Comments in respect of the definition of "illiquid assets" have been set out in Section 2 of our letter.

Borrowing

4. *We seek comment on whether the proposed requirement for non-redeemable investment funds to borrow from a "Canadian financial institution" is appropriate. For example, if the majority of an investment fund's assets are held outside Canada because it focuses on investing in*

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[5] 1974 Mutual Fund Report at p. 28.

[6] http://www.icmagroup.org/assets/documents/About-ICMA/AMIC/AMIC%20response%20to%20IOSCO%20consultation%20report%20_2_.pdf

[7] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD331.pdf

foreign securities, should there be more flexibility to borrow from lenders other than those that are "Canadian financial institutions"? If so, what conditions should the other lenders have to meet?

We do not agree with any restriction that requires borrowing only from Canadian financial institutions. In our view, this is not the appropriate approach for dealing with actual or perceived abusive lending practices. To the extent that the CSA are concerned with conflicts or related-party loans, we submit that these matters are adequately governed in more appropriate ways (e.g. under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") with respect to conflict of interests for registrants, and under NI 81-107 with respect to conflicts of interest for investment funds). If the underlying rationale is that Canadian financial institutions would provide more robust monitoring and controls, conceivably, equivalent foreign institutions would have similar monitoring and controls.

As in a traditional lender/creditor relationship, the risk is borne by the lender and not the borrower. Ultimately, the choice should be based on the risk assessment of the borrower as carried out by the directors, trustees, manager and/or portfolio manager, as applicable, in the proper exercise of their duties.

See our response to Question 4 in Annex B on the imposition of borrowing restrictions generally.

Investments in Mortgages

5. *We invite comment on the impact of the proposed restriction on investments in non-guaranteed mortgages for publicly offered non-redeemable investment funds. We also seek feedback on the transition period for the proposed restriction. If you consider that a transition period longer than 24 months is required, please explain why. Alternatively, if you think that a grandfathering provision is warranted to exempt these types of funds from the application of the proposed restriction on investments in nonguaranteed mortgages, please comment on the impact such a provision could have on fairness to new market participants and investor understanding.*

We note that the definition of mortgage is very broad and covers any debt obligation that is charged on real property (including corporate issue bonds, and other loans) and may, therefore, result in a restriction that is much broader than intended. If these proposals are implemented, mortgage investment entities would need to be grandfathered, or given an appropriate transition period to move to the alternative regime or restructure as industrial issuers as they would otherwise have to cease operations. To the extent that mortgage investment entities would have to restructure as industrial issuers, we further submit that the CSA should coordinate with the Toronto Stock Exchange (the "**TSX**") to ensure this can be accomplished efficiently and without any significant impediments from the TSX's perspective.

Fund-of-Fund Structures

6. *Certain non-redeemable investment funds (top funds) use a forward agreement to obtain exposure to an underlying mutual fund that is not subject to NI 81-102. The underlying mutual fund in this fund-of-fund structure is established solely for the purpose of facilitating the investments of the top fund and it invests in accordance with the restrictions adopted by the top fund.*

Under the Proposed 81-102 Amendments, an underlying mutual fund in a fund-of-fund structure would be required to be subject to NI 81-102. The investment restrictions in NI 81-102 applicable to mutual funds are generally more restrictive than the proposed investment restrictions for non-redeemable investment funds. The CSA are considering measures to enable top funds that are non-redeemable investment funds to continue to use the fund-of-fund structure described in the preceding paragraph, such that the underlying mutual fund may continue to invest in accordance with the investment restrictions applicable to the top fund. We seek comment on whether a carve-out from proposed paragraph 2.5(2)(a) of NI 81-102 would be effective for this purpose and if so, what conditions should attach to the use of the carve-out. Are there appropriate alternative measures to enable an underlying fund that is a mutual fund to follow the investment restrictions applicable to the top fund (a nonredeemable investment fund)?

We believe the ability to invest in (or obtain exposure to) underlying funds should be maintained. There should be no requirement for an underlying fund to be a mutual fund, to comply with NI 81-102 or to "continue to invest in accordance with the investment restrictions applicable to the top fund". Currently, there are underlying funds that do not "invest in accordance with the investment restrictions applicable to the top fund" including Moneda LatAm Corporate Bond Fund, Propel Multi-Strategy Fund, Star Hedge Managers Corp and Star Hedge Managers Corp II.

Similar to a concentration restriction, a "fund-of-fund" restriction could prevent a non-redeemable investment fund from investing in a subsidiary, if that entity was also considered to be a non-redeemable investment fund. Investment in subsidiaries and other investee entities is expressly contemplated by General Instruction 8 to Form 41-101F2, which provides as follows: "Where the term "investment fund" is used, it may be necessary, in order to meet the requirement for full, true and plain disclosure of all material facts, to also include disclosure with respect to the investment fund's subsidiaries and investees. If it is more likely than not that a person or company will become a subsidiary or investee, it may be necessary to also include disclosure with respect to the person or company. For this purpose, subsidiaries and investees include entities that are consolidated, proportionately consolidated, or accounted for using the equity method".

Rather than restricting the type of investment fund in which a non-redeemable investment fund can invest, the focus should be to ensure adequate disclosure. We note that financial and other continuous disclosures can be provided on a look-through basis in accordance with applicable securities law and accounting principles under IFRS. This approach is consistent with the CSA approach under National Policy 41-201 *Income Trusts and Other Indirect Offerings*.

7. *Currently, many managers of non-redeemable investment funds that invest using the fund-of-fund structure described in question 6 have only filed prospectuses for the underlying fund in Ontario and/or Québec even though the prospectuses for the top fund (the non-redeemable investment fund) were filed in all of the jurisdictions of Canada.*

Under proposed amended paragraph 2.5(2)(c) of NI 81-102, the underlying fund must be a reporting issuer in all the jurisdictions in which the non-redeemable investment fund is a reporting issuer. This is intended to prevent an indirect distribution of the securities of the underlying fund in jurisdictions where the underlying fund has not filed a prospectus and to ensure that the local jurisdiction has authority over both the top fund and the underlying fund. Should proposed amended paragraph 2.5(2)(c) apply to non-redeemable investment funds that use a fund-of-fund structure? If not, why not? What other parameters could be used to address the CSA's objectives?

It is a policy position of the Autorité des marchés financiers (the "**AMF**") to require underlying funds to file a prospectus on the basis that providing exposure to an underlying fund constitutes an indirect offering in Canada. We are not aware of any other CSA jurisdiction that takes the same position. In light of the AMF requirement to file a prospectus, some underlying funds formed as trusts have opted to file a prospectus in Ontario as well in order to provide their securityholder(s) (i.e. the counterparty under the forward agreement) the benefit of the limited liability provisions under the *Trust Beneficiaries' Liability Act, 2004* (Ontario).

If the purpose of the prospectus filing requirement is to cause an underlying fund to become a reporting issuer in Canada, then that policy objective is met by filing in one jurisdiction. This procedural step is unnecessary since CSA members are empowered by broad public interest jurisdiction to intervene in activities related to Canadian capital markets, the exercise of which does not depend on reporting issuer status. In most cases, an underlying fund will have a sufficient nexus to a CSA jurisdiction through (a) residence in a CSA jurisdiction (b) ownership of its securities by a "top fund" or a Canadian counterparty (typically a Canadian chartered bank or one of its affiliates); (c) management by a Canadian investment fund manager or portfolio manager or both; and/or (d) custodianship of its assets.

Organizational Costs of New Non-Redeemable Investment Funds

8. *We seek comment on the impact and the benefits and costs of proposed subsection 3.3(3) of NI 81-102. Are there other parameters that could be developed that would achieve benefits similar to the benefits from proposed subsection 3.3(3)? Please also comment on whether the capital raising model followed by non-redeemable investment funds could support the payment of some of the organizational costs out of the proceeds of the initial public offering. Are there specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the manager? Please provide information about these cost components and what fraction each component typically constitutes of the total organizational costs for launching a new fund, and explain why it is appropriate for the fund or the manager to pay the specific cost components.*

We note that these queries seem to suggest a departure from the CSA's traditional position of not regulating pricing.

In our view, the capital raising model followed by non-redeemable investment funds supports the payment of the organizational costs out of the proceeds of the initial public offering ("**IPO**"). From a fairness perspective, it seems that the IPO costs are borne by the right investors. In the case of mutual funds that are in continuous distribution, issue costs are recouped from investors over time through redemption fees and higher management fees. Non-redeemable investment funds principally issue securities on their IPOs and so IPO investors bear such costs.

Non-redeemable investment funds, unlike other IPO issuers are, as a matter of best practice established by investment dealers and other industry participants, subject to a cap on offering expenses of 1.5% of the gross proceeds of the offering (2% in the case of Flow-Through Funds).

Having regard to the fact that a non-redeemable investment fund prospectus is a long form prospectus and that there is substantial vetting by the agents and their own separate counsel, many of the most expensive IPO costs of a non-redeemable fund offering are fundamentally different from the costs of a mutual fund and include:

(a) The costs of issuer's counsel and agents' counsel and the auditors to prepare a long form prospectus on Form 41-101F2 (65-75%);

(b) Preparation, printing and delivery of long form prospectuses (8-10%);

(c) Marketing costs (8-12%);

(d) Translation costs (5-8%); and

(e) TSX listing fees, as well as prospectus filing fees (8-10%). We note in Ontario the fee for filing a Preliminary or Pro Forma Simplified Prospectus and Annual Information Form in Form 81-101F1 and Form 81-101F2 is $400 as compared to $3,250 for a prospectus filed in Form 41-101F2 (or any other form available to a non-redeemable investment fund).

We note that the Notice indicates that the CSA expect that organizational costs paid by the manager will be recouped through higher management fees. We are concerned that substituting one form of recovery from investors for another will lead to overall higher fees paid by investors as the higher management fees will never be reduced. In addition, smaller and less capitalized managers may be limited in their ability to fund upfront organizational costs which would limit new entrants and investor choice and could lead to a market dominated by larger players.

While not stated in the Notice, we understand that the "specific components of organizational costs" about which the CSA are most concerned are so-called "marketing costs". From a policy perspective, there should not be any distinction between IPO costs borne by industrial issuers (such as REITs or mortgage investment entities) and non-redeemable investment funds. We also note that such costs are generally a small portion of the organizational costs.

Finally, as we have noted above, the CSA, like the OSC, should be guided by the principle that: "Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized."[8]

Dilutive Issuances of Securities

9. *The CSA propose to introduce subsection 9.3(2) to prevent issuances of securities that cause dilution to the NAV of other outstanding securities of a non-redeemable investment fund. Proposed subsection 9.3(3) recognizes that a non-redeemable investment fund that raises additional money from the public through a new issuance of securities must include the price of the securities in the prospectus. We invite comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.*

We do not believe that a restriction on dilutive issuances needs to be codified into the rules. This is an issue that should be left to the fund managers or directors/trustees of the fund to determine in the proper exercise of their duties. They are in the best position to determine whether growth through a further issuance of securities is desirable and/or beneficial given the needs and the context of each particular fund. To the extent the dilutive issuance gives rise to a conflict of interest, appropriate safeguards apply under National Instrument 81-*107 Independent Review Committee for Investment Funds*.

Naming Convention for Investment Funds

10. *Please see question 13 in Annex B.*

The classification of funds as "conventional" or "alternative" may be useful from a regulatory perspective, but we do not agree that a naming convention is required. We are not opposed to a requirement to disclose the type of investment fund through a legend requirement or as currently required under Item 1.3 of Form 41-101F2.

The term "alternative fund" may not be a useful categorization for a unique asset class or a suitable naming convention for non-redeemable investment funds, generally. Within the non-redeemable investment fund universe there are important distinctions among funds that are material and more relevant for inclusion in the name of a fund such as "Canadian", "Split" and "Limited Partnership". These naming conventions provide useful disclosure relevant to an investment decision

[8] *Securities Act*, R.S.O. 1990, c. S.5, s. 2.1(6).

whereas a generic term like "alternative fund" does not. Given the differences that can exist even within a specific group of funds (conventional or alternative), in our view, imposing a uniform descriptor may be misleading and confusing to the extent it implies uniformity among all the funds in the same group.

Transition Period for Investment Restrictions in Proposed Amended NI 81-102 and Alternatives

11. *We are proposing that existing non-redeemable investment funds be required to comply with the investment restrictions in proposed amended sections 2.2, 2.3 (other than paragraph 2.3(2)(b)), 2.4 and 2.5 of NI 81-102 18 months after the first coming-into-force date of the Proposed 81-102 Amendments pertaining to these sections. We invite feedback on whether the proposed transition period is sufficient. If not, please provide reasons for a longer transition period or provide alternatives to a transition period.*

If you think that a grandfathering provision is warranted for existing non-redeemable investment funds, please comment on the scope of a grandfathering provision and explain why existing non-redeemable investment funds should not have to comply with specific sections in Part 2 of NI 81-102. Please also comment on the impact a grandfathering provision could have on fairness to new market participants and investor understanding.

In our view, given the significant changes that such restrictions would represent, we think that it is appropriate to grandfather existing non-redeemable investment funds for an indefinite period of time. On balance, we think that grandfathering of all existing non-redeemable investment funds will lead to the least confusion and inequity for securityholders and all other market participants. Grandfathering preserves the investment decision made by investors based on full disclosure of the investment objectives and restrictions in effect at the relevant time.

In the alternative, 18 months is not a sufficient transition period given the changes that will need to be made in order to comply, including amendments to relevant constating documents and material agreements, obtaining of securityholder approval, as applicable, and investment reallocation, as well as other technical and procedural changes. The approval requirements will also require careful consideration. As a matter of fairness, in light of the coercive nature of a right of expropriation, we assume securityholders will be provided with approval rights. This raises numerous questions such as who will bear the costs of such meetings and what will happen if securityholders do not approve the changes. Absent this approval and consent, it seems unfair for securityholders or investment fund managers to bear the costs of amendments to the bargain that was reached at the time of investment.

A number of funds may also be forced into asset liquidation, which would give rise to other complications and issues that may be more detrimental to securityholders than the perceived benefits that the proposed restrictions are intended to provide. If investors want to exit an investment fund that is grandfathered, they will be free do so. They can sell their securities into the market or redeem their securities. If investors wish to amend the terms of a grandfathered fund, they will be equally free to do so. They can requisition a meeting to effect the desired change. The market, not the CSA, should be the arbiter of whether grandfathered funds and next generation NI 81-102 (or NI 81-104) compliant investment funds can co-exist.

Anticipated Costs of the Proposed Amendments and of Implementing the Alternative Funds Framework

12. *Do you agree or disagree that the costs of the Proposed Amendments and the proposals relating to NI 81-104 are proportionate to the benefits? We seek specific data from non-redeemable investment funds and commodity pools on the anticipated costs and benefits of complying with the regulatory framework set out in the proposed amendments to NI 81-102 and the alternative funds regulatory framework being contemplated in NI 81-104.*

As stated in response to Question 2 above, we cannot comment on the impact of the proposed amendments without further details on what the alternative regime will encompass. The details of the alternative regime will dictate, to a large extent, whether a fund will choose to continue under NI 81-102, having made any required changes, or will elect to be governed under NI 81-104. The costs associated with making such an election will depend on the extent to which NI 81-104 will accommodate an existing fund on an "as is" basis.

ANNEX B - SPECIFIC QUESTIONS OF THE CSA RELATING TO THE ALTERNATIVE FUNDS FRAMEWORK IN NI 81-104

Definition of "Alternative Fund"

1. *Does the use of the term "alternative fund" appropriately describe the types of investment funds that should be captured by NI 81-104? If not, please propose other terms that better describe the types of investment funds that use investment strategies that should be permitted under a revised version of NI 81-104.*

See our response to Question 10 in Annex A (Naming Convention for Investment Funds).

Investment Restrictions

Concentration Restriction

2. *We seek feedback on the types of investment strategies an alternative fund may engage in that would require a fund's investment in an issuer to exceed the current 10% concentration restriction in proposed amended NI 81-102. If you think that the concentration restriction under NI 81-104 should be higher than the current 10% issuer concentration limit in NI 81-102, please provide feedback on what an appropriate concentration restriction would be for alternative funds. See also question 2 in Annex A.*

To provide a truly alternative regime, we believe that alternative funds should not be subject to any concentration restriction. For similar reasons as set out in our response to Question 2 in Annex A (Concentration Restriction), we reiterate that a concentration restriction should be tailored to address the liquidity needs of the particular fund. Liquidity is also facilitated through an appropriate redemption notice period that can be tailored to the nature of the assets held by a fund. Any investor risk concerns should be addressed through appropriate disclosure. Imposing a concentration restriction will effectively remove from investors the ability to invest in alternative investment strategies that cannot otherwise be effected. In this respect, the alternative regime should permit flexibility for investment funds to provide such investment alternatives to investors for whom it is an appropriate and desirable investment.

Like the proposed fund-of-fund restrictions, a concentration restriction will be problematic for fund-of-fund structures, for the ownership of subsidiaries, current two-tier funds (that have exposure to a single counterparty or underlying fund), split share corporations (that can have exposure to a single underlying investment or a concentrated sector, such as banking or insurance) and Flow-Through Funds. Flow-Through Funds typically have the ability to invest more than 10% of a fund's net asset value in a single resource issuer. This market practice has developed over the past 30 years based on the availability of suitable flow-through investments for Flow-Through Funds.

3. *Given that we anticipate alternative funds having more leveraged exposure than is permissible under NI 81-102, should we consider other measurements for an alternative fund's concentration? Should issuer concentration for alternative funds be based on the total notional exposure of the fund? We seek feedback on this and other measurements that would better describe the level of concentration in an alternative fund portfolio.*

We agree that concentration should be measured based on total notional exposure. A number of non-redeemable investment funds have filed prospectuses with disclosure of "notional" and "net" exposures. The concepts of leverage and exposure should be applied consistently among all types of investment funds, since mutual funds can also engage in short selling and can purchase or enter into specified derivatives for hedging and non-hedging purposes.

Borrowing

4. *Should alternative funds that are structured as mutual funds and alternative funds that are structured as non-redeemable investment funds have different borrowing restrictions in NI 81-104? Would a mutual fund's need to fund regular redemptions mean that the amount of leverage through cash borrowings could increase rapidly and cause difficulties in maintaining the 3:1 total leverage limit we are considering?*

In our view, non-redeemable investment funds should not be subject to any restriction on borrowing (i.e. the use of financial leverage) or the use of leverage generally (i.e. through derivatives or otherwise). We think that borrowing and leverage are best addressed through disclosure, consistent with the best practices outlined by IOSCO in its final report on Principles for the Regulation of Exchange Traded Funds.

Determination of the adequate leverage ratio should be left to the discretion of fund managers and directors/trustees who are in the best position to determine what is in the best interests of the fund, based on the particular needs and context of the fund. As noted above, the use of leverage is subject to careful scrutiny by the investment dealers who sign the prospectus. This dynamic, case-by-case process, together with disclosure, is more effective than a bright line borrowing restriction, as it takes into account the particular asset class and investment strategy whereas a bright line test does not. Further, any consideration of borrowing is also used as a key tool to strengthen a fund's investment portfolio and can enhance investor returns. Some investors may seek out funds that utilize various borrowing techniques to achieve such enhancements, and should not be restricted in the choices available to them. Any concerns relating to risk can be appropriately addressed through disclosure, thereby providing the investor with the opportunity to make a fully informed choice. As the CSA have noted, a number of non-redeemable investment funds are subject to borrowing restrictions. This demonstrates that the market operates efficiently to provide investors with a range of investment vehicles, including those with borrowing restrictions, and refutes the need for such restrictions to be statutorily codified.

Short Selling

5. *Should NI 81-104 include exemptions from subsections 2.6.1(2) and (3) of NI 81-102 to permit the creation of leverage through short selling and increase flexibility for alternative funds to engage in long/short strategies?*

We agree that NI 81-104 should provide the flexibility for funds to implement a range of investment strategies, including the creation of leverage through short selling and long/short strategies. Imposition of such a restriction would impede investor choice by limiting the range of investment strategies that can be employed.

Counterparty Credit Exposure

7. *We seek feedback on the impact to existing commodity pools that are relying on the Counterparty Exposure Exemption if this exemption in NI 81-104 were to be repealed.*

Would repealing the Counterparty Exposure Exemption sufficiently mitigate the risk of exposure to a single counterparty, particularly in connection with illiquid OTC derivatives? Are there other ways we should consider to mitigate counterparty risk; for example, by requiring the posting of collateral by the counterparty? If so, what requirements should apply to the use of collateral? If an alternative fund receives collateral from a counterparty to a specified derivatives transaction, should the collateral be considered in determining the alternative fund's exposure to the counterparty?

We do not agree that the Counterparty Exposure Exemption needs to be repealed as, in our view, it is not clear there is any risk from single counterparty exposure that needs to be mitigated.

Total Leverage Limit

8. *Do you agree with a total leverage limit for alternative funds of 3:1 based on the leverage calculation method currently specified in Item 6.1 of Form 41-101F2? If not, what should the total leverage limit of an alternative fund be, and why? Should the total leverage limit be lower for mutual funds that are alternative funds because of the need to fund regular redemptions?*

As previously stated, in our view, NI 81-104 should not impose any restrictions on leverage for alternative investment funds. NI 81-104 should provide a truly alternative regime that will permit for a range of investment strategies that are required in order to meet investors' needs. Further, given the types of alternative investment strategies employed, including the use of derivatives and similar instruments (and the purposes therefore), imposition of a leverage restriction will lead to complications in terms of calculation and application of the restriction.

9. *What other leverage measurement methods could be used to inform investors of the amount of leverage used by alternative funds, other than the method currently specified in Item 6.1 of Form 41-101F2? Please also explain why the alternative leverage measurements you propose provide investors with a better understanding of the amount of leverage used by alternative funds.*

The issue of appropriate leverage measurement methods is best addressed by industry participants. However, the applicable concept/method that is ultimately chosen should, in our view, be clearly formulated, expressed and disclosed and uniformly applicable.

Other Investment Restrictions for Alternative Funds

10. *Are there other specific investment strategies that NI 81-104 should permit or restrict?*

As expressed in a number of our comments above, in our view, NI 81-104 should provide a truly alternative regime and therefore not impose any additional restrictions. The purpose of NI 81-104 should be to provide for ample flexibility for alternative investment strategies that do not otherwise fall under NI 81-102. This is necessary in order to preserve a range of investment choices currently available to investors. Any relevant concerns relating to the difference in restrictions among NI 81-102 funds and NI 81-104 funds should be dealt with through appropriate disclosure.

On-going Investment by Sponsors

11. *Should the sponsors of an alternative fund be permitted to withdraw their seed capital investment in the alternative fund if the fund reaches a sufficient size? Or should the sponsors be required to maintain an investment in the alternative fund? We invite feedback on why sponsors should be required to maintain an on-going investment in an alternative fund and the amount of on-going investment that would be appropriate.*

We agree with the position articulated on page 6 of the Notice that the seed capital requirements should not apply to non-redeemable investment funds.

Proficiency

12. *Should additional proficiency requirements for all individual dealing representatives who sell securities of alternative funds be introduced? If yes, please provide specific examples of the courses or experience that should apply. If no, please explain.*

We concur with the submission of the Canadian Securities Institute in their comment letter dated June 27, 2013, that it would be redundant to impose another level of proficiency for IIROC registered representatives.

Enhanced Disclosure and Transparency

Naming Convention

13. *Would requiring an alternative fund to include the words "Alternative Fund" in its name achieve the purpose of distinguishing alternative funds from other investment funds for investors and the market? If not, please propose other ways to facilitate the ready identification of alternative funds.*

In addition, would requiring investment funds governed only by NI 81-102 to include specific words (e.g., "Conventional Fund") in their name further this purpose? If not, why not? Would the diversity of investment funds that are governed only by NI 81-102 and their different risk levels impede the creation of a uniform descriptor for such funds?

See our response to Question 10 in Annex A (Naming Convention for Investment Funds).

Monthly Website Disclosure

14. *We seek feedback on whether there are any impediments for an alternative fund to disclose on its or its manager's website on a monthly basis (with appropriate time lag for the manager to prepare the information) the fund's largest monthly NAV drawdown for the past five years and the maximum and average daily leverage employed during the most recent 12 month period. We further invite feedback on whether this information will be useful to investors or the market generally.*

Is there other information that could be provided regularly on the website of the alternative fund or its manager that would be meaningful for investors or for the market?

We think disclosure of monthly performance data would be more meaningful to investors. We do not think it would be fair or balanced to restrict the disclosure to the "fund's largest monthly NAV drawdown for the past five years and the maximum and average daily leverage employed during the most recent 12 month period". Additionally, such limited disclosure could be misleading. Disclosure of a maximum drawdown number in the absence of further information is not useful to an investor; it is equally or more important to know how a fund has performed since the time of investment (i.e. is it up or is it down?). For example, would an investor rather own a volatile fund that has had a large drawdown, but has since recovered (or is trending up) or a less volatile fund with a small drawdown that is still under water (or trending down)?

Various investment fund managers have, from time to time, proposed inclusion of monthly performance data in investment fund prospectuses as part of full, true and plain disclosure, but generally have been restricted to disclosure of prior performance in accordance with General Instruction 11 to Form 41-101F2, pursuant to which performance data is presented in the prospectus, annual compound returns must be presented for standard applicable performance periods of 1, 3, 5 and 10 year periods and the period since inception unless otherwise specified by the requirements of this Form. We encourage the CSA to revisit the prohibition in Instruction 11 of Form 41-101F2 against the disclosure of performance data for periods of less than one year by allowing non-redeemable investment funds that have been in existence for at least one year to present monthly performance data.

Prospectus Disclosure

We do not agree that an alternative fund should be required to disclose in its prospectus under the "Investment Strategies" heading how its investment strategies differ from those of a "conventional" investment fund under NI 81-102.

Such disclosure is not relevant and it is potentially misleading. In addition, it seems inconsistent to suggest that an alternative fund would be required to include a comparison of investment strategies in a prospectus while at the same time the CSA are "considering prohibiting alternative funds from comparing themselves to other types of investment funds in their sales communications". As with the proposed website disclosure, this seems to emphasize risks of alternative funds without the benefits.

Transition

15. *How should the disclosure of an existing investment fund's intent to transition into the alternative fund regime in NI 81-104 be made? For example, should investors be provided with written notice or would a press release be sufficient? In addition to disclosing their intent to transition into the alternative fund regime, what other measures should be required for existing investment funds to transition into the alternative fund regime?*

As we have stated in our response to Question 11 in Annex A (Transition Period for Investment Restrictions in Proposed Amended NI 81-102 and Alternatives), in our view, all existing investment funds should be grandfathered indefinitely under the current regime. To the extent that a fund wishes to convert into an alternative fund, the existing requirements, including securityholder approval requirements, should be sufficient to provide securityholders with notice of the proposed transition.

Costs and Benefits of Implementing Alternative Funds Framework

16. *Please see question 12 in Annex A.*

See our response to Question 12 in Annex A (Anticipated Costs of the Proposed Amendments and of Implementing the Alternative Funds Framework).

ANNEX C - SPECIFIC QUESTIONS OF THE CSA RELATING TO SECURITIES LENDING, REPURCHASES AND REVERSE REPURCHASES BY INVESTMENT FUNDS

The CSA are considering measures to enhance the transparency of the benefits, costs and risks of securities lending, repurchase and reverse repurchase transactions conducted by investment funds. We seek feedback on the following issues.

The CSA understand that it is common practice for securities lending agents to be compensated through receiving a share of the revenue generated from lending securities, repurchases and, if a lending agent is used, reverse repurchases. We also understand that some managers have established revenue-sharing arrangements under which revenue is shared between the investment fund and a lending agent related to the manager or between the investment fund and the manager. As the investment fund bears all the risks from securities lending, repurchases and reverse repurchases, the CSA are of the view that the revenue from engaging in these activities, after the payment of costs for conducting the activities, should be received only by the investment fund.

Currently, depending on the terms of the securities lending agreement, the financial statements of an investment fund that engages in securities lending may disclose the revenue from securities lending net of the lending agent's share. Further, in such cases, the amount paid to the lending agent does not appear in the financial statements as a cost of conducting the activities.

While the amount of revenue generated by securities lending and repurchases may be relatively small, the CSA are of the view that because mutual funds (and, under the Proposed 81-102 Amendments, all investment funds) may lend, or sell in repurchase transactions, up to 50% of total assets, information about the returns, costs and risks of securities lending and repurchase activity is relevant to investors.

The CSA think that it is important for investors to understand the returns from securities lending and how such revenue has contributed to the performance of the investment funds. We also think it is important for investors to be aware of the costs, the profitability and the scope of an investment fund's securities lending activities, so that they can assess the efficiency of the lending. Transparency of the revenue and cost is particularly important if the investment fund uses a lending agent that is related to the manager, which may give rise to conflicts of interest. Further, if the related lending agent *shares in the revenue from securities lending, the manager could market its funds to investors as having a management fee that is lower than it would otherwise be, without investors being aware of the additional compensation paid to the affiliated lending agent through the revenue sharing arrangement.*

Accordingly, we are considering measures to enhance the transparency of the benefits from securities lending and the costs paid to earn the returns. We are of the view that disclosure of the gross returns from, and the costs of, securities lending would provide additional transparency.

We seek feedback on approaches that would achieve the outcome of providing disclosure of the gross returns and the costs of securities lending.

1. *Are there other costs of conducting securities lending, other than the fee paid to the lending agent?*

   As a general comment we note that securities lending should be viewed from the perspective that it is a beneficial portfolio management tool that results in a net benefit to the fund. We do not believe that there are any additional costs of conducting securities lending, other than customary legal and administrative costs associated with entering into the securities lending arrangement itself. In our view, the regulatory focus with respect to securities lending should be on adequate disclosure of risks and any potential conflicts of interest, which are adequately addressed under existing disclosure requirements.

2. *What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the revenue from securities lending inclusive of the share paid to the agent? What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the costs of securities lending?*

   These issues could be addressed through a requirement for additional note disclosure, subject to confirmation by issuers of the availability and costs of tracking such information.

4. *We think that the disclosure of the returns and the costs of repurchases should be the same as the disclosure of securities lending, since both activities are substantively similar. Should the same type of disclosure for reverse repurchases be provided? Should the returns and costs of securities lending and repurchases be aggregated, rather than disclosed separately?*

   Securities lending arrangements are typically managed by an agent and are subject to an additional fee, whereas reverse repurchase arrangements are normally managed by a fund's portfolio manager without an incremental fee. The portfolio manager's services are covered by a portfolio management agreement. Accordingly, we do not agree that similar or aggregated disclosure should be provided.

7. *Items 3.4 and 19 of Form 41-101F2, Item 5 of Part A and Item 4 of Part B of Form 81-101F1, and Item 10 of Form 81-101F2 require disclosure in an investment fund's prospectus or annual information form (AIF), as applicable, regarding certain service providers to the fund.*

The CSA are considering adding the agent in respect of securities lending, repurchases and, if applicable, reverse repurchases to the list of service providers detailed in these Items. Another outcome of adding the agent to these Items would be that the agent's relationship to the manager would also be disclosed in the prospectus or AIF, so that investors can assess whether amounts are being paid to entities affiliated with the manager in connection with the investment fund's securities lending, repurchase or reverse repurchase activities. Is this disclosure useful? Should any additional details regarding the agent be provided in an investment fund's prospectus or AIF?

This disclosure may be appropriate for agents in respect of securities lending arrangements. However, we do not believe this disclosure would be useful in respect of repurchase or reverse repurchase arrangements as such arrangements are normally managed by a fund's portfolio manager and are not managed by way of an agency relationship.

8. *We understand that investment funds may seek different indemnities from their lending agent, which provide varying degrees of protection from losses that could arise from securities lending. Would disclosure of the indemnities obtained by an investment fund from its lending agent in the AIF or prospectus of the investment fund be useful for investors in assessing the risks from securities lending?*

It would be disproportionate to require disclosure in respect of one particular indemnity arrangement when a fund has many others. In our view, to the extent there is any material risk associated with the indemnity arrangements between a fund and its lending agent, such risk should be disclosed through applicable risk disclosure requirements. We do not believe this disclosure would otherwise be useful to investors.

9. *Generally, investment funds do not file the agreements that they enter into with their lending agent on SEDAR. Currently, these agreements are not listed in the AIF under Item 16 of Form 81-101F2 or the prospectus under Item 31 of Form 41-101F2. Should these agreements be required to be included as material contracts and filed on SEDAR?*

In our view, the current requirement relating to the filing and disclosure of material contracts, other than those entered into in the ordinary course, is an adequate test for capturing contracts that are not otherwise specified in Form 81-102F2. We do not believe that these agreements need to be added to either Item 16 or Item 31.

SECTION 2 – SPECIFIC COMMENTS ON PROPOSED AMENDMENTS TO NI 81-102

PART 1 – DEFINITIONS AND APPLICATION

"illiquid assets"

The definition should be clarified as certain elements of the definition can be difficult to interpret and apply, such as reference to "public quotations" and "restricted security." It is not clear what is intended to be captured by "public quotations" where securities or instruments are not listed on conventional exchanges. In our view, the requirement that there be "public quotations" is not necessary as it should be adequate that a price can be determined through independent sources. We also note that it is unclear whether, through the use of the defined term "restricted security," and only partial repetition of the definition, the intention is to exclude a security whose resale is restricted by law.

PART 4 – CONFLICTS OF INTEREST

We agree that the conflicts of interest provisions in Part 4 of NI 81-102 should apply to non-redeemable investment funds. Further, it would be helpful if the conflicts of interest and self-dealing provisions in Part 4 of NI 81-102 could be consolidated and harmonized with similar provisions in section 13.5(2)(b) of NI 31-103 and securities legislation, generally (as set forth in Appendices A and B of NI 81-107 *Independent Review Committee for Investment Funds*).

PART 5 – FUNDAMENTAL CHANGES

5. 1 Matters Requiring Securityholder Approval

We agree with these approval requirements and that Flow-Through Funds should be exempted from such approval requirements if they are effecting a rollover into a mutual fund (a "mutual fund rollover transaction"), provided that certain requirements, including prospectus disclosure requirements, are met. Consistent with current market and administrative practice, we ask the CSA to expressly state that Flow-Through Funds are exempt from the prohibition on inter-fund trades in Section 13.5(2)(b) in connection with effecting a rollover transaction given that such a transaction cannot be completed in compliance with Section 6.1 of NI 81-107. See for example, *Canoe Financial LP, Re,* 2013 ABASC 318.

5.8.1 - Termination of Non-Redeemable Investment Fund

It should be clarified what is intended to be captured as a "termination". Further, thirty days is an insufficient period of time in which to terminate a fund. The intention to terminate must, as a material change, be communicated as soon as the decision is taken, but it will take considerably longer for a fund to wind up its affairs, provide for all of its liabilities and distribute its net assets to its securityholders, particularly if it owns illiquid assets. We are not sure why the CSA are attempting to prescribe a "termination" period. The time it takes to wind up a fund will, in many respects, be beyond the control of a manager and will depend on such factors as the nature of the portfolio, the manager's ability to maximize securityholder value, and the provision for the liabilities of the fund, all in the context of prevailing market conditions.

Several funds we have assisted in winding up have been confronted by one or more illiquid assets that are difficult, if not impossible, to dispose of. It would be useful if the CSA would consider allowing a manager to hold such assets in trust on the wind-up of a fund as a principled and practical solution for disposing of assets with nominal value. This would require a carve out from the self-dealing provisions.

PART 6 – CUSTODIANSHIP OF PORTFOLIO ASSETS

We agree with the proposal to update the drafting in Part 6 of NI 81-102 based on the drafting in NI 41-101, and apply the updated NI 81-102 requirements to non-redeemable investment funds. However, we do not understand the statement that "There are no substantive changes to the custodian requirements for any investment funds, other than requiring all non-redeemable investment funds, rather than only those that file a prospectus under NI 41-101, to comply with the custodianship requirements." By definition, NI 81-102 only applies to reporting issuers.

The funds managed by pooled fund managers (i.e. hedge fund managers), generally, are not subject to NI 41-101 or NI 81-102 and, as such, these managers would not be aware of this proposal. If the CSA do intend to require all non-redeemable investment funds to comply with the custodianship requirements, then we suggest a separate notice should be published specifically for the hedge fund industry.

PART 7 – INCENTIVE FEES

We submit that the standard set forth in NI 81-104 is appropriate for all non-redeemable investment funds, provided that the method of calculation of the fee is disclosed in the prospectus.

PART 9 - SALE OF SECURITIES OF AN INVESTMENT FUND

9.3 Issue Price of Securities

We note that, as drafted, the proposals in subsection 9.3(2) introduce some uncertainty in the pricing of a new issue offering of securities of a non-redeemable investment fund and would suggest that the CSA adopt a formulation that allows the price of the offering to be fixed based on the most recently determined NAV prior to the pricing of the offering. Otherwise, it is not possible to know whether an offering can proceed.

PART 11 – COMMINGLING OF CASH

These trust account provisions seem well-suited for the electronic mutual fund settlement network run by FundSERV Inc. However, most non-redeemable investment funds, unlike mutual funds, are held on a non-certificated basis, through the book-entry only system of CDS Clearing and Depository Services Inc. ("**CDS**"). As such, non-redeemable investment funds typically make distributions through third party distribution agents (that also serve as registrar and transfer agents) and redemptions are typically effected through CDS. Trust account requirements should not apply to such "qualified transfer agents" or CDS. A "qualified transfer agent" could be defined as an "entity appointed as transfer agent or registrar of an investment fund that satisfies the requirements of section 6.2." Section 11.4(1) could be amended as follows: "Sections 11.1 and 11.2 do not apply to a member of IIROC, CDS or a qualified transfer agent."

PART 18 – SECURITYHOLDER RECORDS

We note that unlike mutual funds, the securities of most non-redeemable investment funds are book-entry only (and uncertificated) through the facilities of CDS. In such circumstances, CDS is the sole registered securityholder and, as a result, securityholder records are limited.

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This letter represents the general comments of certain individual members of our securities practice group (and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

We thank you for the opportunity to express our views on these matters. Should you have any questions or require additional information, please do not hesitate to contact any of the following individuals: Darin R. Renton (416-869-5635 or drenton@stikeman.com), Joel Binder (416-869-5233 or jbinder@stikeman.com), Nick Badeen (416-869-5220 or nbadeen@stikeman.com), Philip Henderson (416-869-5691 or phenderson@stikeman.com), Kathleen Ward (416-869-5617 or kward@stikeman.com), Alix d'Anglejan-Chatillon (514-397-3240 or adanglejan@stikeman.com), Jeffrey Elliott (416-869-5655 or jelliott@stikeman.com) or Ramandeep Grewal (416-869-5265 or rgrewal@stikeman.com).

Yours truly,

(Signed) STIKEMAN ELLIOTT LLP