August 5, 2000

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland
Securities Registry, Government of the Northwest Territories
Registrar of Securities. Government of the Yukon Territory

C/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8

C/o John Claude St. Pierre, Secretary
Commission des valeures mobilieres du Quebec
800 Victoria Square
Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montreal, Quebec H4Z 1G3

Noreen Bent
Senior Legal Counsel
British Columbia Securities Commission

Dear Sirs/Mesdames:

Re: **<u>Proposed National Instrument 81-104- Commodity Pools & Companion Policy 81-104CP</u>**

I am writing in response to the formal request for the second round of comments on the proposed National Instrument 81-104 - Commodity Pools and the companion policy 81-104CP. Before I get to my comments on the proposed policy, there are a few other general comments that I would like to make for the record.

As I was involved in the first round of comments, in addition to meeting with Senior Legal Counsel of the British Columbia Securities Commission, I am some what concerned with the exercise, process and value in submitting to this perceived collaboration of industry expertise and regulatory due process. From my perspective, all our comments and concerns expressed in our meeting, and in the formal written comments supplied in the first round, appear to have fallen on deaf ears. In fact, in conversations I had with senior legal counsel at the BCSC, it was made clear to me they had no expertise in this side of the industry and in fact were just following the lead of the OSC. This would certainly appear to be the case in light of the fact that our first round of comments had little if no impact on the proposed changes released after the first comment period. In Fact, I can't be certain that our concerns and thoughts on these issues were ever made clear to the CSA committee that was drafting the proposed changes.

More to my point, I would like to take this opportunity to point out what I believe is the most important issue at hand as it pertains to the proposed rules in 81-104-Commodity Pools and Companion Policy 81-104CP, and for that matter any other rule that attempts to protect the Canadian investor by eliminating potential investment options open to them.

I don't believe the CSA, and the respective Canadian commissions represented by the committee, should take it upon themselves to regulate with can do's and cant's as would pertain to investment product opportunities for Canadian investors. Regulations should not preclude investment opportunities based on net worth resulting in a situation where those with money have greater access to investment styles, vehicles and products because they have money. Instead, a greater emphasis should be placed on suitability, and the disclosure of the issues that help determine that suitability. And I mean suitability form the perspective of the portfolio, not an individual net worth or the regulators perception of their investment acumen. I believe the CSA and others should place all the regulatory emphasis on product liability, disclosure, and industry professional/investor education, and let the responsibilities of the broker and the clients investment objective's determine the final investment decision when the regulatory process has determined that a proposed product has no investor liability beyond an investors initial investment.

To illustrate my point, the following scenario with the current proposed rules could have the following consequences for Canadian investors, and serves to demonstrate the inadequacy of the CSA's current proposed changes.

To buy a commodity pool by prospectus, current suitability requirements suggest a net worth level that would preclude an investor with a $20,000 net worth from making the investment. Suppose this investor has learned that commodity pools have historically reduced his overall portfolio risk and provided a greater opportunity to diversify his portfolio of investments and management style with an additional benefit of being profitable in both bull and bear markets. Furthermore, the investors learns that limited liability hedge funds and commodity pools are commonly used by high net worth investors and institutions because of these benefits. Taking it a step further, this investor is 26 years old and has a portfolio comprised of an assortment of equity mutual funds. The account is serviced by a financial planner who has recognized the benefits of this asset class, and is in full agreement that his client could benefit from such an investment.

The advisor and the client would like to have 15% ($3,000) of the portfolio placed in this limited liability commodity pool mutual fund that is managed by on of the world's prominent commodity trading advisors. The proposed 15% investment was determined by efficient frontier analysis of the clients current mutual fund holding in conjunction with an efficient inclusion of a managed futures product designed to increase the return and reduce the risk of the clients current portfolio of investments.

However, the advisor and client learn that the Canadian regulatory bodies believe that this advisor and client should only be able to buy products or investments that are profitable in bull markets. Furthermore, if they don't believe in the current bull market options, they can subsidize our financial institutions by buying GIC's and can forget about the possibility of having the investment options that are open to professionals or high net worth investors. The regulator's tell the advisor, that the limited liability commodity pool mutual fund that the client is interested in uses leveraged positions represented by futures contracts, and that neither the advisor or the client are sophisticated enough to understand the impact of such unlimited liability instruments in their limited liability investment. The advisor tells the regulator that the fund has no liability beyond the investment and that the client is buying the investment management style, product diversification and performance characteristics the product asset class represents, not futures contracts. The advisor further points out that the product is managed by professionals who do understand these instruments, and is more than satisfied with there credentials and track record that was disclosed in the limited liability mutual fund prospectus.

The advisor continues to point out that the regulators themselves have required the following statement on the front of the prospectuses for such offerings, " This prospectus constitutes a pubic offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence.", and with two key points, the fund being a security and regulators absolving themselves from any product responsibility, the advisor expresses concern over there perceived right to prevent the advisor from selling a security that the advisor is licensed to sell, and more importantly, expresses concern over there right to prevent client access to a product, that they themselves, will not except any responsibility for.

The regulators come back with how they are looking out for the best interests of those involved, and that if the advisor takes a special course that teaches them about futures they can sell this special product, a limited liability mutual fund security that uses leveraged futures contracts, to their high net worth clients only. The advisor responds with, why can I sell index funds that use futures contracts to replicate an index. The regulator's say, that's different, those funds don't use futures in a leveraged manner within the fund. The regulators say they understand why they use futures, so its OK for the client, but we don't understand why anybody would buy a product that invests in global markets using futures contracts as the investment medium. The advisor counters by pointing out that domestic RRSP eligible foreign index funds use leveraged futures positions, why am I allowed to sell those products that use index futures to replicate the index and invest a majority of the fund assets (80%) in domestic treasuries for taxation reasons which results in a leveraged net asset value in the product. The regulators respond with, that's not a commodity pool. The advisor continues again to point out that the commodity pool is embedded in a limited liability mutual fund security, the fund's advisor has a long-term track record that demonstrates characteristics that will help my clients' portfolios. The advisor tells the regulators that the commodity advisor only invests in portfolio of global stock indices represented by futures contracts. The regulators, boxed in a corner, come back with, we don't what another Orange County, were just trying to protect your interests.

On and on this process would go, until the bigger forces in the investment industry decided is was in their best interest to have the rules changed. The bigger firms and management organizations don't care to comment because they don't have an interest. The few large Exchange contract dealers in this country, that you would think should comment, will only comment on anything that prevents their business from developing the products they envision. They certainly won't comment on proficiency proposals that currently give them a marketing edge. They like the perceived specialty stigmatism the regulators place on selling securities that have an alpha associated with a managed futures program. The sad thing is that non of this is in the best interest of Canadian investors, and what is in there best interest is not being serviced when our regulatory process removes choice from the process due in large part to ignorance and fear.

I think its clear from my introduction that my comments for the current proposed 81-104-Commodity Pool and 81-104CP, are very straightforward. In the context of a limited liability mutual fund that has a return generated from a managed futures, or for that matter, a hedge fund program, remove all rules that prevent the asset classes from functioning as they would in the exempt world. This would include any and all rules on investment style, leverage, markets traded, benchmarks, and fees. Let the investor, his or her advisor and the firms they represent determine the suitability of the investment. Instead, place the regulatory focus on disclosure and product structure from the liability prospective. Make sure that both the investor and the advisor have the opportunity to know everything they need to know to make the investment decision, and make sure when they do, their liability is limited to their principal investment.

If this can be accomplished in the purist form, any and all investment opportunities and the asset classes they represent will have a preferred path to the investor from both the regulatory and distribution perspective. Other less desirable methods of accessing managed futures and hedge fund alpha's will not have the opportunity to flourish by bypassing the regulatory process, unless those product types are institutionally calibrated, Like guaranteed bank notes that are linked too managed futures programs that are a complete farce and completely misleading to the investor. Or exempt limited partnerships that are restricted to higher net worth investors under the assumption that because they have more money there more sophisticated. Both of these examples have resulted in products being sold that are fare from ethical because larger fund companies and their respective management have been prevented from offering these asset classes in the vehicles that have gained so much investor acceptance and require a higher level of regulatory approval. Furthermore it would give regulators the opportunity to regulate the entire investment process, from product to management, inclusive of pre-trade, post- trade, distribution and investor transparency. This should be the exercise of the CSA, not the return merit of a given investment for which is clearly not within the regulatory mandate or skill sets.

As fare as sales proficiency requirements are concerned, if the CSA feels that sales proficiency should be broadened, then they should address it from the perspective of the whole industry, and they should do it by increasing the standards of the current securities licensing program. As for a commodity pool sold in a structure the provides a limited liability mutual fund security, which in my opinion is in fact a security, the proficiency issue should be addressed within the context of a securities license and educational standards required too attain one.

As advisor(s) would not be executing a futures transaction on behalf of a client when selling this type of product, like they are not executing one when the buy a index fund that uses futures contracts to replicate an index, the thought of some special derivative course required to sell a mutual fund that makes use of derivatives in the context of a commodity pool, that regulators can't appear to define based on other products excluded from the proficiency thought process, would seem preposterous. Furthermore, any such requirement would have a real negative impact on commodity and/or hedge fund managers that wish to develop or whom have developed product(s) that represent this asset class, because the majority of securities/fund dealers are note going to run out a get an extra level of education to sell a minority asset class/product.

It seems to me the CSA should consider a continuing education requirement for those licensed to sell securities, and from time to time when innovative new products or asset class opportunities present themselves, the required upgrading could be mandated in some kind of upgrade program. Other professional organizations have been able to achieve continuing educational standards, why not the investment industry.

I think if the CSA takes a long hard look at what they're contemplating, and adopts an approach that is designed to be more flexible, the future regulatory burden of managing new products and investment opportunities as the markets and industry evolve will be less disruptive to the industry and more efficient for our regulatory infrastructure. Particularly important to me, specialty managers, like myself, will be free to create and manage new innovative investment opportunities without the constant battle of excessive regulatory interference.

In closing, I would like to point out a few misconceptions and common prejudices that I believe the CSA and others in our Canadian regulatory commissions seem to carry with them when considering proposed rules and regulations for managed futures/hedge fund products. If the CSA or any other interested party cares, all of these comments can be back up with mountains of evidence, if necessary.

1) Historically, professional managed futures programs have proven to be no more, or less, risky than any other professionally managed asset classes or security-type.
2) In fact, over the last several years, many other asset class products and securities have proven to be more risky.
3) Commodity markets have been less volatile than NASDAQ over the last many years.
4) Commodity pools primarily use financial futures represented by government interest obligations, foreign currencies and stock indices.
5) Top ranked commodity trading advisors have historically out-performed many, if not most, other asset classes and their respective manager specialists.
6) Risk can be controlled
7) An equity mutual fund, a bond mutual fund and a commodity pool mutual fund have the exact same liability potential for their respective investors. All can theoretically lose their entire investment, and only their entire investment.
8) Modern portfolio theory has proven that diversification into additional positive performing asset class investments increases a portfolio's performance and reduces its risk.
9) The price of a security/derivative can, and dose, go down as often as it can go up. Investor's products that take advantage of both potential scenarios historically can have performance characteristics that result in higher returns with less volatility and risk.

Sincerely,

Douglas Sereda
President, Senior Portfolio Manager
Matisse Investment Management Ltd.