NATIONAL BANK
SECURITIES

September 24, 2010

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Dear Sir:
Dear Madam:

Subject: Proposed NI 81-102 Mutual Funds

National Bank Financial Group is pleased to respond to the Request for Comments dated June 25, 2010 where the Canadian Securities Administrators (CSA) invited interested parties to submit additional comments on the Proposed changes to NI 81-102 Mutual Funds.

The Financial Group commends the regulatory authorities for their efforts to enhance the current regulatory framework. This objective favours both investors and industry players by making sure regulation stays well adapted to the needs and expectations of all market participants.

Through our comments, we hope to improve certain aspects of the proposed Framework and avoid the undesirable effects that might occur were it to be applied in its current form.
The scope of our mutual fund activities puts us in a privileged position to fully understand the proposed amendments, as National Bank Financial group manages and offer a wide range of funds, with local, national or international content. Our products are distributed via a vast network that includes advisors in 442 bank branches and 105 securities brokerage offices, specialized advisors and direct distributors, such as direct securities brokerage. The Bank is one of the top 20 mutual fund businesses in the country and the leading Quebec banking institution.

In general, we support the comments made by IFIC and CBA on the proposed changes.

Money Market Funds

The current dollar-weighted average term to maturity (WAM) limit in the definition of "money market fund" requires a money market fund to maintain a portfolio with a WAM limit not exceeding 90 days that is calculated on the basis that the term of a floating rate note (FRN) is the period to the next rate setting of the note. However, in the propose changes to sections 1.1 and 2.18, the CSA proposed to maintain the current limit and to combine it with a WAM limit of 120 days that is calculated based on the actual term to maturity of all securities in a money market fund portfolio including FRN.

The following highlights why such a change could potentially have negative impacts on money market funds across the industry:

- Adding a second methodology to calculate the fund's WAM would force the sale of many FRNs with longer maturity dates; the rush to sell longer term FRNs would generate a liquidity issue which in turn would impair FRN values when fund managers are forced to sell and realize unnecessary losses. In a more extreme case, this could entail the need for a fund manager to compensate losses in money market funds in order to avoid bringing the net asset value under par (commonly known as avoiding *breaking the buck)*;
- The elimination of FRNs would decrease diversification in a market that is already highly concentrated – and less diversification means increased risk;
- Since the yield on short term FRNs is not as high as on the long term FRNs, performance of money market funds would be negatively affected. Unitholders would see their (already modest) returns diminish which may lead them to resort to riskier alternatives; and
- Decreased demand for longer term FRNs could ultimately increase the cost of funding for issuers as the future of the FRN as a product could be threatened.

We recommend that the current method used for calculating WAM, which uses the interest rate reset date of an FRN as the term to maturity, remain the only method to calculate WAM. However, should the proposed changes be adopted, we submit that grandfathering provisions would be appropriate, allowing funds to continue to hold the long term FRNs held before the changes come into force. Alternatively, the CSA could grant a transition period of at least 2 years before the 120-days WAM calculation comes into effect. These transition measures would allow funds to gradually reduce their FRNs and purchase shorter term securities while maintaining market integrity. Establishing a grandfather clause would circumvent the rush to sell longer term FRNs, avoid market disruption and impairment to FRN values. We encourage the CSA to engage with market participants to explore the practical market impacts in order for the CSA to make an informed decision.

We do not support a reduction of the 90-day limit to a shorter time frame. Although similar measures were adopted by the SEC, the Canadian money market fund industry is very different than that of the United States and therefore measures adopted in the latter would not necessarily be appropriate for the former. It is important to note that the Canadian money market funds withstood the liquidity crisis of 2008-2009 and so we believe that the proposed amendments would impose unnecessary restrictions on an otherwise liquid market. For more information in this regard, we refer to IFIC's comments on the matter (Part II – Other Comments on the Proposed Amendments – Money Market Funds).

We are also of the view that the CSA should not impose any limit on the exposure of a money market fund to FRN. However, if the CSA is open to reconsider imposing the 120-day WAM, other limits may be more appropriate to manage risk and ensure good governance of money market funds, such as:

- A maximum concentration limit in FRNs: We are of the view that, in order to obtain optimal performance, a maximum concentration limit of 30% or 35% would be appropriate. However, considering the CSA's concerns in this respect, we believe that a maximum concentration limit of 20% would be acceptable; and
- A maximum term to maturity for any FRN of 4 years. However, we are of the view that it would be acceptable that certain FRNs have a shorter term to maturity considering their risk level (type of issuer, credit rating, etc.).

Combined, these constraints could be an effective way of achieving the goal of improved investor protection while maintaining an acceptable level of yield in money market funds.

Index Participation Units

We welcome the changes to include index participation units ("IPU") traded on a stock exchange in the United Kingdom in the definition of "index participation units". However, we recommend expanding the definition to include exchanges in other developed markets such as Japan, France, Germany and Hong Kong.

A mutual fund with an international investment objective may at times want to temporarily increase or decrease exposure to an international index through the use of an IPU and the best option for doing so may be the IPU of an international issuer. For small exposure increases or decreases, the portfolio manager will search for the index participation unit with a acceptable NAV and adequate liquidity to ensure efficiency of the transaction and avoid any pricing issues. As well, if the mutual fund's objective is to be exposed to the foreign currency, the fund manager will specifically look for an IPU that exposes the fund to the foreign currency of the index and is not hedged back to local currency. In such a case, it is highly possible that such an IPU only exists on a foreign exchange.

For example, a mutual fund which aims to achieve long-term capital growth primarily through the investment in securities listed on the Paris Stock Exchange would be better off if the fund were allowed to invest in the Lyxor CAC 40 when temporarily increasing or decreasing the fund's exposure. The iShares MSCI France Index Fund which tracks the same index would not be the manager's first choice since it is less liquid, has a higher expense ratio, and is hedged back to USD (please refer to Exhibit 1).

Exhibit 1

France

Largest France Fund traded in US (exposed to currency movements of EURO)

Name	Ticker	Price*	Fees	Average Daily Volume	NAV (USD)
iShares MSCI France Index Fund	EWQ	$ 23.23	0.55%	532,404	136,000,000

Largest France Fund traded in France

Name	Ticker	Price*	Fees	Average Daily Volume	NAV (EUR)	NAV (USD)
Lyxor CAC4 40	CAC	€ 37.36	0.25%	1,112,122	2,912,020,000	3,808,048,356

*Prices as of the close on 9/16/2010

Permitted supranational agency

The CSA propose to modify to the definition of "permitted supranational agency". We support the proposed modification and in addition, we propose that the CSA add the European Investment Bank (EIB) to the definition. The following is an extract from the website of the EIB (http://www.eib.org):

> "*The European Investment Bank was created by the Treaty of Rome in 1958 as the long-term lending bank of the European Union. The task of the Bank is to contribute towards the integration, balanced development and economic and social cohesion of the EU Member States.*
>
> *The EIB raises substantial volumes of funds on the capital markets which it lends on favourable terms to projects furthering EU policy objectives. The EIB continuously adapts its activity to developments in EU policies.*
>
> *Besides supporting projects in the Member States, its main lending priorities include financing investments in future Member States of the EU and EU Partner countries. The EIB operates on a non-profit maximising basis and lends at close to the cost of borrowing. The Bank's consistent AAA rating is underpinned by firm shareholder support, a strong capital base, exceptional asset quality, conservative risk management and a sound funding strategy.*
>
> *In 2009, the EIB raised nearly EUR 79.4 billion.*"

We thank you for the opportunity to provide the foregoing comments and hope these comments are useful. We welcome any questions you may have and would be pleased to discuss the matter further with you as required.

Sincerely,

Charles Guay
President and Chief Executive Officer