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September 24, 2010

SUBMITTED BY E-MAIL

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
(collectively, the "**CSA**")

Dear Ladies and Gentlemen:

Re: National Instrument 81-102 *Mutual Funds* ("NI 81-102") and National Instrument 81-106 *Investment Fund Continuous Disclosure* ("NI 81-106") – Comments on Proposed Amendments Announced June 25, 2010 (the "Proposed Amendments")

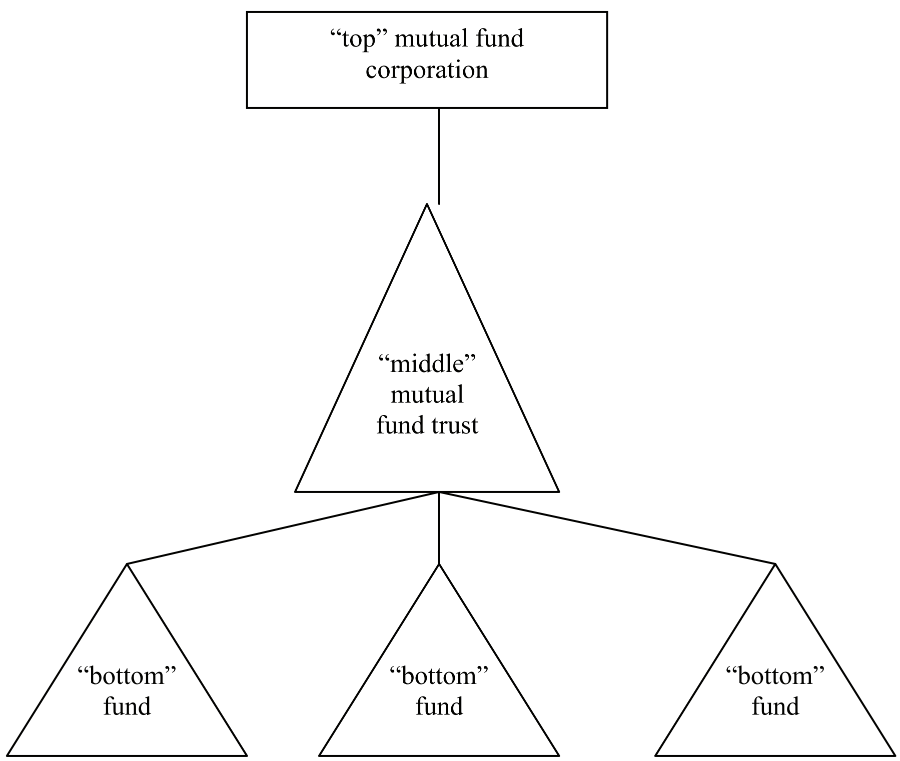
Thank you for providing us with the opportunity to comment on the Proposed Amendments. Our comments are set out below. All terms herein have the respective meanings given to them in NI 81-102 or NI 81-106 unless otherwise defined in this letter.

Three-tier investing

By adding the new defined term "clone fund" and changing the reference in paragraph 2.5(4)(a) of NI 81-102 from "RSP clone fund" to "clone fund", the Proposed Amendments will slightly increase the ability of mutual funds to engage in three-tier investing (e.g. permitting a "top" mutual fund to invest, directly or indirectly, in securities of a "middle" mutual fund which, in turn, invests, directly or indirectly, in securities of a "bottom" mutual fund) . Under the Proposed Amendments, "clone fund" will be defined as a mutual fund that has adopted an investment objective to link its performance to the performance of another mutual fund.

In our view, these changes are unnecessarily narrow and preclude a number of three-tier investing scenarios that would be advantageous to investors, including those which the CSA already have permitted by discretionary relief.

For example, a “middle” fund that invests in multiple “bottom” funds simultaneously (such as a “fund-of-funds”) will not qualify as a “clone fund” under the Proposed Amendments since its performance will be linked to the performance of more than one bottom fund. This would arise in a situation where a manager wishes to offer both a mutual fund corporation version and a mutual fund trust version of a fund-of-funds. Rather than creating duplicate fund-of-funds, greater efficiency is achieved by allowing the “top” mutual fund corporation to invest in the “middle” mutual fund trust which, in turn, invests in a portfolio of underlying funds as depicted below:



As well, a “middle” fund that does not identify in its investment objective the particular “bottom” fund to which its performance is linked will not qualify as a “clone fund”. This will limit the ability of the middle fund to change its bottom fund (such as to a more attractive fund, or in response to a mutual fund reorganization) since it will trigger a requirement to convene a meeting of securityholders to approve a change to the investment objective of the middle fund.

Initially, fund-on-fund investing was prohibited due to concerns over (among other matters): possible duplication of management fees, possible conflicts of interest associated with exercising voting rights of the bottom fund, and transparency of the investment exposure of the top fund. We suggest that these regulatory concerns have since been addressed through the conditions included in section 2.5 of NI 81-102, as well as the financial reporting requirements applicable to fund-on-fund investments introduced by NI 81-106. (See, for example, Instruction (8) to Form 81-106F1, Part B, Item 5 regarding look-through disclosure of portfolio holdings, and section 15.2 of NI 81-106 regarding the calculation of management expense ratios for fund-on-fund investment structures.) For this reason, we submit that there no longer is a need to limit three-tier investing to situations where the middle fund is a "clone fund", provided the other conditions of section 2.5 of NI 81-102 are satisfied.

Accordingly, we recommend that:

- all references in NI 81-102 to "RSP clone fund" be deleted,
- the new term "clone fund" <u>not</u> be added to NI 81-102, and
- paragraph 2.5(2)(b) of NI 81-102 be deleted.

Short selling

The Proposed Amendments will codify the ability of mutual funds to engage in a limited amount of short selling. We note that the Proposed Amendments do not include all of the conditions typically imposed on short selling by previous discretionary relief. For example, under the Proposed Amendments, there will be no requirement for:

- the issuer of the securities sold short to have a market capitalization of not less than $100 million (instead, the securities sold short must not be an "illiquid asset" as defined in NI 81-102), nor
- the fund to simultaneously place a stop-loss order at not more than 120% of the price at which the securities were sold short.

The Proposed Amendment will include certain new limitations on short selling by mutual funds.

The Proposed Amendments likely will trigger sunset clauses in existing discretionary relief, thereby requiring that existing mutual funds that rely on such relief transition to the new requirements within a period of time. Both the existing discretionary relief and the Proposed Amendments contemplate that (a) mutual funds that engage in short selling include certain disclosure in their prospectuses regarding short selling, and (b) mutual funds that commence short selling provide certain notice to their existing securityholders.

Without further clarification, it is possible that existing mutual funds that engage in short selling in reliance on discretionary relief may be required to amend their current prospectuses and deliver new notices to their existing securityholders in order to transition to the requirements of the Proposed Amendments. Since the Proposed Amendments regarding short selling (a) are essentially intended to be a codification of past discretionary relief, and (b) introduce changes to the conditions associated with short selling that may be considered immaterial, we submit that existing mutual funds with discretionary relief to short sell should not be required to amend their prospectuses solely for these purposes, nor be required to deliver new notices to existing securityholders.

Accordingly, we recommend that the Companion Policy to NI 81-102 be amended to clarify that, notwithstanding the Proposed Amendments to section 2.11 of NI 81-102, existing mutual funds that currently are permitted to engage in short selling pursuant to discretionary relief are permitted to engage in short selling on the terms contained in the Proposed Amendments without complying with section 2.11 provided the information required by section 2.11(a) is added to the prospectus of the mutual fund when it is next renewed or amended (whichever occurs first).

Investing in index participation units

By redefining the scope of index participation units ("**IPUs**") to include IPUs traded on a stock exchange in the United Kingdom, the Proposed Amendments will expand the list of investments by mutual funds in exchange-traded mutual funds ("**ETFs**") permitted by section 2.5. However, the Proposed Amendments do not capture the scope of other discretionary relief which has been granted frequently, namely the ability of mutual funds to invest up to 10% of their net assets in ETFs which do not qualify as IPUs.

To avoid the cost and inefficiency of further applications for discretionary relief in this regard, we suggest that the Proposed Amendments include a codification of such discretionary relief by adding a new definition of "reference-based ETF", together with a new subsection to section 2.5, as follows:

> "reference-based ETF" means an exchange-traded mutual fund that seeks to provide daily results that replicate the performance of either:
>
> (1) a specified widely-quoted market index by a multiple of 200% or an inverse multiple of 200%, or
>
> (2) a commodity, or the value of a specified derivative the underlying interest of which is a commodity on an unlevered basis, by a multiple of 200%.
>
> Paragraphs 2(a) and 2(c) do not apply if the security is of a reference-based ETF and:
>
> (1) the investment by the mutual fund in the security is in accordance with the fundamental investment objective of the mutual fund,

(2) the mutual fund does not short sell the security,

(3) the security is traded on a stock exchange in Canada or the United States,

(4) the security is treated by the mutual fund as specified derivatives for the purposes of Part 2 in this Instrument,

(5) immediately after the purchase of the security, the aggregate market value of all securities of reference-based ETFs held by the mutual fund does not exceed 10% of the net asset value of the mutual fund,

(6) immediately after the purchase of the security, the aggregate market value of all securities of reference-based ETFs held by the mutual fund and all securities sold short by the mutual fund does not exceed 20% of the net asset value of the mutual fund, and

(7) the prospectus of the mutual fund includes a description of

(a) reference-based ETFs,

(b) the extent to which the mutual fund may invest in reference-based ETFs, and

(c) the risks associated with investments by the mutual fund in reference-based ETFs.

Money market funds

The Proposed Amendments include new investment restrictions for money market funds. We defer to the comments that will be provided by portfolio managers to the CSA concerning these new restrictions, and encourage the CSA to carefully consider the feedback they will receive in this regard.

In particular, the Proposed Amendments concerning money market funds appear to be a reaction to an extraordinary, "once-in-a-century" market downturn. While the Proposed Amendments may increase the liquidity of money market funds, there is no assurance that these new measures would be sufficient should another extraordinary market downturn occur in the future, nor can such measures protect a money market fund from a decline in its net asset value per unit ("**NAVPU**").

From a liquidity perspective, we note that the Securities and Exchange Commission has considered providing money market fund managers with greater flexibility to suspend redemptions in certain circumstances, but we have not seen the CSA give consideration to a similar change in Canada. We submit that many of the concerns regarding liquidity and declining NAVPUs can be addressed by permitting money market funds to suspend redemptions in extraordinary circumstances.

We also note that much of the impetus for change resulted from the momentary declines in the NAVPUs of money market funds below targeted amounts (typically $10.00 in Canada) during the credit crisis. While Canadian money market funds attempt to maintain constant NAVPUs, there is no assurance that this can be maintained under all market conditions. In fact, members of the CSA often required that the prospectus disclosure of money market funds be revised to reflect (rather prophetically) that a money market fund's NAVPU could decline. In addition, Form 81-101F1, Part A, Item 4(3) requires that a money market fund's prospectus disclose that its NAVPU can decline, and that an investment in a money market fund is not analogous to a bank account or GIC.

We are concerned that the Proposed Amendments to money market funds are, at least in part, a response to an event that the CSA predicted (and accepted) could happen and that is already described in a simplified prospectus. We suggest that part of the focus of the CSA should be on investor education such that the general public better understand that an investment in a mutual fund is not the same as placing money in a bank account or GIC.

Circumstances in which approval by securityholders is not required (changes to expenses)

Existing ambiguity

The Proposed Amendments to section 5.3 of NI 81-102 will clarify certain aspects of the application of paragraphs 5.1(a) and 5.1(a.1). However, there continues to be uncertainty regarding the circumstances in which an increase in charges to a mutual fund by a third party will (or will not) require that 60 days' notice be given to securityholders of such mutual fund.

For example, it is common for mutual funds to be responsible for paying all of their operating expenses, which may include costs such as (a) printing and mailing of financial statements and management reports of fund performance, (b) legal, audit and custodian fees, and (c) filing fees payable to securities regulators. Each of these costs may increase over time. As well, it is possible that new operating expenses will arise in response to industry changes (for example, the costs associated with implementing the new Harmonized Sales Tax). It is generally accepted that these types of increases to annual operating expenses do not trigger the requirement to provide 60 days' advance notice to securityholders, but this is not confirmed by either NI 81-102 or the Proposed Amendments.

Accordingly, we recommend that the Companion Policy to NI 81-102 be amended to confirm that where a mutual fund is required by its existing constating documents and/or management agreement to bear an operating expense, any increase to such operating expense does not constitute a change to "the basis of the calculation" of the operating expense. Similarly, where a mutual fund is required by its existing constating documents and/or management agreement to bear all operating expenses (other than any specific expenses which may be excluded), the introduction of a new non-excluded operating expense will not constitute a change to "the basis of the calculation" of the operating expense.

Ambiguity arising from the Proposed Amendments

The Proposed Amendments will avoid the need for obtaining securityholder approval in certain circumstances when a new fee or expense is to be charged by a mutual fund or its manager to the mutual fund or its securityholders in connection with the holding of securities of the mutual fund. In order to qualify for this exception, the person or company charging the fee or expense must be at arm's length to the mutual fund.

We have difficulty envisioning a circumstances when a mutual fund or its manager will be considered "at arm's length" from the mutual fund in order to satisfy the condition in section 5.1(a.1) of NI 81-102. We suggest that these circumstances be clarified in the Companion Policy to NI 81-102.

Circumstances in which approval by securityholders is not required (fund mergers)

When National Instrument 81-107 *Independent Review Committee for Investment Funds* ("**NI 81-107**") was enacted, NI 81-102 was simultaneously amended to permit an independent review committee (an "**IRC**") to effectively approve a merger of mutual funds, thereby avoiding the cost associated with convening a meeting of the securityholders of the terminating mutual fund to approve the merger. These changes were, and remain, deficient in two respects.

First, the changes do not permit the IRC to approve the merger on behalf of the continuing mutual fund when the merger is considered to be a material change for the continuing mutual fund. This is an anomaly that likely was an oversight when drafting the amendments described above. Prior to NI 81-107, it was the view of the CSA that every merger was a material change for the terminating mutual fund, which is the reason that section 5.1(f) of NI 81-102 does not contain a "materiality" test. Depending on the factual circumstances, a merger may or may not constitute a material change to the continuing mutual fund that participates in the merger. Where the merger will constitute a material change for the continuing mutual fund, we see no reason for withholding authority for the IRC to approve the merger on behalf of the continuing mutual fund as well, thereby avoiding the cost associated with convening a meeting of securityholders of the continuing mutual fund.

Second, it has become routine for the CSA to approve a wide variety of mutual fund mergers which do not satisfy one or more of the conditions contained in section 5.6 of NI 81-102. Some of the most common situations where a condition is not satisfied include the following:

- a reasonable person might not consider the fundamental investment objective and/or fee structure of the continuing mutual fund to be substantially similar to the terminating mutual fund, contrary to section 5.6(1)(a)(ii) of NI 81-102;
- the merger is not implemented as a "qualifying exchange" or other tax-deferred transaction referred to in section 5.6(1)(b) of NI 81-102;
- where securities of the continuing mutual fund are distributed under a multiple SP (as defined in NI 81-101) and Part A and Part B of the multiple SP are bound together, securityholders of the terminating mutual fund receive a "tailored" simplified prospectus comprised of only Part A and Part B of the continuing mutual fund, rather than the entire multiple SP, contrary to section 5.6(1)(f)(ii) of NI 81-102; and
- the financial statements of the continuing mutual fund are made available upon request to securityholders of the terminating mutual fund rather than mailed to such securityholders, contrary to section 5.6(1)(f)(ii) of NI 81-102.

To avoid the cost and inefficiency of further applications for discretionary relief in this regard and the costs of convening meetings of securityholders of the continuing mutual funds in appropriate circumstances, we suggest that the Proposed Amendments include a codification of most common circumstances in which approvals are granted by the CSA pursuant to section 5.5(1)(b) of NI 81-102. According, we recommend that the following subsections be added to section 5.6 of NI 81-102:

> (3) Despite subsection 5.6(1), paragraph 5.6(1)(a)(ii) does not apply if the circular sent to securityholders of the mutual fund pursuant to paragraph 5.6(1)(f)(i) contains sufficient information concerning the differences in the fundamental investment objectives, valuation procedures or fee structure (as applicable) to permit securityholders of the mutual fund to make an informed decision concerning the merger.
>
> (4) Despite subsection 5.6(1), paragraph 5.6(1)(b) does not apply if the circular sent to securityholders of the mutual fund pursuant to paragraph 5.6(1)(f)(i) contains sufficient information concerning the tax consequences of the merger to permit securityholders of the mutual fund to make an informed decision concerning the merger.
>
> (5) Despite subsection 5.6(1), the requirement in paragraph 5.6(1)(f)(ii) to send the current simplified prospectus for the mutual fund into which the mutual fund will be reorganized does not apply if:

(a) such simplified prospectus is a multiple SP in which Part A and Part B are bound together, and

(b) securityholders are sent an excerpt from such simplified prospectus containing Part A and Part B of the current simplified prospectus for the mutual fund into which the mutual fund will be reorganized.

(6) Despite subsection 5.6(1), the requirement in paragraph 5.6(1)(f)(ii) to send the most recent annual and interim financial statements that have been made public for the mutual fund into which the mutual fund will be reorganized does not apply if:

(a) the circular sent to securityholders pursuant to paragraph 5.6(1)(f)(i) prominently discloses that securityholders can obtain such financial statements by contacting the manager at a toll-free number, from the internet at www.sedar.com and from the manager's website,

(b) upon request by a securityholder for such financial statements, the manager makes its best efforts to provide the securityholder with such financial statements in a timely manner so that the securityholder can make an informed decision concerning the merger, and

(c) the financial statements delivered to the securityholder contain an unqualified audit report.

For greater certainty, we recommend that the following paragraph be added to the Companion Policy to NI 81-102:

> Subsections 5.6(3), 5.6(4), 5.6(5) and 5.6(6) do not apply in determining whether the condition specified in subsection 5.5(2)(c) has been satisfied.

We further recommend that NI 81-102 and NI 81-107 be amended to permit IRCs to approve mergers on behalf of continuing mutual funds on the same basis as they are authorized to approve mergers on behalf of terminating mutual funds.

Suspension of redemptions by clone funds

The Proposed Amendments will allow a clone fund to suspend redemptions of its securities at any time that the underlying fund to which its performance is linked has suspended redemptions. We submit that this amendment, though an improvement on the current provisions of NI 81-102 by codifying past discretionary relief in this regard, does not adequately address all the circumstances in which a mutual fund should be permitted to suspend redemptions relating to fund-on-fund investments.

When trading in portfolio securities held by a mutual fund is suspended, two risks arise, namely:

- the risk that the mutual fund will be unable to calculate its net asset value per security accurately due to the absence of a current market price for a significant portion of the mutual fund's investment portfolio, and
- the risk that the mutual fund may be required to dispose of a disproportionate amount of the liquid portion of its investment portfolio (possibly at unfavourable prices) in order to fund redemptions, resulting in an adverse impact to the mutual fund's market exposure.

It is for this reason that a mutual fund is permitted by section 10.6 of NI 81-102 to suspend redemptions when, generally speaking, trading is suspended on stock exchanges on which more than 50% (by market value) of the portfolio securities held by the mutual fund are traded.

The same risks can arise when a mutual fund invests in multiple underlying funds and one or more of such underlying mutual funds suspends redemptions. If the mutual fund is required to continue honouring redemptions in these circumstances, it could result in the mutual fund processing a redemption using an incorrect net asset value per security. It also could result in the mutual fund's investment portfolio becoming materially imbalanced.

The Proposed Amendments will address this concern only for mutual funds that obtain exposure to a single underlying fund, effectively setting the illiquidity threshold for suspending redemptions at 100% of the mutual fund's investment portfolio. Instead, we recommend that the Proposed Amendment utilize a 50% threshold equivalent to other securities which may be held by the mutual fund. For this reason, we suggest that proposed section 10.6(1)(b) instead state the following:

> "redemptions of securities of other mutual funds held by the mutual fund, or which are the underlying interest of specified derivatives to which the mutual fund is a party, are suspended and such securities represent more than 50% by value of the total assets of the mutual fund without allowance for liabilities."

Continuous disclosure requirements of limited life funds

The Proposed Amendments will permit limited life funds to avoid the cost and environmental impact of preparing continuous disclosure information under NI 81-106. In making this change, the CSA have acknowledged that no useful purpose is served by requiring the investment fund to prepare an annual information form since no further trading in securities of the investment fund will occur. We submit that these Proposed Amendments are too narrow in two respects.

First, the Proposed Amendments will require that the investment fund be terminated within 24 months of its formation. However, there are a number of circumstances when this will not be the case. For example, it is not uncommon for a limited partnership to be formed in anticipation of flow-through offering, but later experience a delay in commencing the offering which could result in the investment fund remaining in existence beyond 24 months after its formation. As well, it is not uncommon for an investment fund to remain in existence for a number of months after its investors have been removed from the investment in order that the investment fund may maintain its status for tax purpose for a completed financial year. Accordingly, rather than require that the fund be terminated within 24 months of its formation, we recommend that paragraph (c) of the definition of "limited life fund" instead state the following:

> whose prospectus discloses that the investors in the investment fund (other than its manager, promoter or any affiliates thereof) will cease to be investors in the investment fund within 24 months following the completion of the initial public offering by the investment fund.

Second, we suggest that the benefits of reduced continuous disclosure should be extended to all defunct investment funds, not merely limited life funds. For example, when an investment fund terminates, it may be in the same situation as a limited life fund for a period of time (e.g. it has no investors (other than possibly its manager, promoter or an affiliate thereof) in order to maintain its status for tax purposes. We submit that there is no benefit to public in requiring that an investment fund in these circumstances continue to prepare continuous disclosure documents since there are no arm's length investors in the investment fund and no intention to make a further distribution of securities by the investment fund. Accordingly, we recommend that the following provision be added to NI 81-106 as a new subsection 9.2(3):

> Subsection 9.2(1) does not apply if:
>
> (a) the investment fund has no securityholders other than securityholders who are the manager or promoter of the investment fund or an affiliate of the manager or promoter of the investment fund, and
>
> (b) the investment fund has issued a press release announcing its intention to terminate and that it will not make a further distribution of securities prior its termination.

We further recommend that as part of the Phase 2 amendments to NI 81-106, the CSA consider extending the application of subsection 9.2(3) above to include financial statements, management reports of fund performance and quarterly portfolio disclosure.

Change of control of managers

Though not part of the Proposed Amendments, we note that through its recent publication and subsequent application of OSC Staff Notice 81-710 ("**81-710**"), Ontario Securities Commission staff has materially changed the basis on which a mutual fund manager may be acquired without the need for approval by securityholders of the acquired manager's mutual funds.

Prior to 81-710, it was commonplace for the operations of an acquired manager to be consolidated into the acquiring manager soon after closing in order to commence realizing operational efficiencies from the elimination of redundancies. This consolidation could include the amalgamation or dissolution of the acquired manager in order to avoid the cost of maintaining multiple registered portfolio managers.

Since 81-710, OSC staff has required that such streamlining be curtailed or deferred, otherwise OSC staff will require that securityholders of the acquired manager's mutual funds approve the change of control. We believe that this change raises at least three issues.

Uncertainty of treatment in other jurisdictions

Since 81-710 is solely an OSC staff notice, it is unclear whether other CSA members agree with, and will apply the same approach as, OSC staff. Parties currently attempting to negotiate the purchase and sale of a mutual fund manager where Ontario is not the principal jurisdiction cannot predict whether the terms of CSA approval pursuant to section 5.5(2) of NI 81-102 will require that inefficiencies from the separation of the two fund managers persist for the foreseeable future following closing. We request that the CSA clarify their position on 81-710.

Merits of 81-710

81-710 states that OSC staff will consider the intended outcome for the securityholders of the acquired manager's mutual funds in determining whether to require the approval of such securityholders. We have a concern that 81-710 does not expressly acknowledge that such considerations will include an assessment of the materiality to securityholders of the changes resulting from post-closing consolidation efforts. A recent approval under section 5.5(2) for which Ontario was the principal regulator required that the acquired manager remain the manager of its mutual funds for the foreseeable future and that there be no intention to merge the acquired manager into the purchaser for the foreseeable future (see *Re Navina Asset Management Inc.* (July 23, 2010)). This condition effectively requires that the managers maintain redundant registrations and related personnel and supporting systems even though the elimination of such redudancies through a post-closing merger may have no material impact on securityholders. Further, the administrative efficiencies (and lower management expense ratios) that may result for such a post-closing merger may outweigh any non-financial impact of such changes on securityholders.

For these reasons, we ask that the CSA provide guidance on the circumstances in which parties may contemplate a post-closing merger without the change of control transaction being recharacterized as a change of manager of a mutual fund.

Procedural requirements

As described above, OSC staff's application of 81-710 has resulted in a material change to the manner in which section 5.5(2) has applied to the change of control of a manager. This change has potentially far-reaching ramifications, including that it could materially reduce the ability of small managers to merge together to form larger, more competitive managers. We submit that a change of this significance should be submitted for public consultation through the rule-making processes of Canadian securities legislation. We encourage the CSA to revisit this issue through a proposed amendment to 81-102 or its companion policy and, in the interim, suspend the application of 81-710.

We trust that the foregoing comments will be of assistance to the CSA. We would be pleased to elaborate upon our comments at your request.

Yours very truly,

Fasken Martin DuMoulin LLP