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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

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs / Mesdames:

RE: CSA Staff Notice 81-322 Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project and Request for Comment on Phase 2 Proposals (the "Staff Notice 81-322")

Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") on Staff Notice 81-322 related to the National Instrument 81-102 ("NI 81-102") Modernization Project Phase 2.

Fidelity Investments Canada ULC ("Fidelity Canada") is the 6th largest fund management company in Canada and part of the Fidelity Investments organization in Boston ("Fidelity Investments"), one of the world's largest financial services providers. Fidelity Canada manages a total of $68 billion in mutual funds and institutional assets and offers approximately 190 mutual funds and pooled funds to Canadian investors.

Fidelity Canada is the manager and trustee of 83 open-ended mutual fund trusts and through its affiliate Fidelity Capital Structure Corp. offers 59 classes of redeemable mutual fund shares (together "the Funds"). Each of these products is subject to NI 81-102. Fidelity Canada believes it is essential that the ongoing NI 81-102 rule review process and mutual fund investment management requirements keep pace with investment fund product innovation in the Canadian market while protecting investors and mitigating product and market risk. Our responses to the CSA's request for comment are noted below.

Our comments on Staff Notice 81-332 are organized as follows:

A. The Rule Review Process
B. Stand-Alone Rule on Non-Redeemable Investment Funds
C. Physical Commodities and New Derivative Strategies

Furthermore, we offer some other miscellaneous comments on NI 81-102 which are set out in Schedule "A" to this comment letter and reiterate, in some cases, comments that we previously provided in respect of Phase 1 of the Modernization Project.

A. The Rule Review Process

Since the introduction of NI 81-102 in early 2000, mutual fund products have evolved to meet the changing needs of investors. Concurrently, however, the availability of competing investment fund products (that are subject to different regulatory regimes) has increased substantially, highlighting the need for a regulatory framework that supports mutual fund product innovation in a flexible, timely and cost effective manner. Phase 1 of the NI 81-102 Modernization Project and the codification of frequently granted exemptive relief is a positive first step in catching up to this need. However, we recommend that the CSA consider establishing an ongoing process for reviewing NI 81-102, soliciting industry comment and amending NI 81-102 on a more frequent basis to ensure the regulatory framework evolves and keeps pace with product innovation, evolving capital markets and the needs of investors. This process could be established as a regularly scheduled CSA review and industry comment process. Alternatively, it could be triggered by the frequent approval of substantively new exemptive relief applications.

B. Stand-Alone Rule on Non-Redeemable Investment Funds

We believe that non-redeemable investment funds should have their own stand-alone rule and are supportive of the CSA's objective to consider efficiency, investor protection and fairness issues that arise out of the different regulatory regimes that apply to different types of publicly-offered investment funds.

Retail investors buy a variety of fund types that compete with open end mutual funds that are essentially managed in the same way but without the redemption feature. These other fund types offered to retail investors should, in our view, be subject to the same regulatory rules that apply to open end mutual funds so that their investors enjoy the same protections afforded to investors in open end mutual funds. For example, the pure retail investor who invests in a closed-end fund, such as a resource limited partnership, may believe that they have the same level of regulatory protections and be exposed to the same risk as they would have in other retail structures such as open end mutual funds.

A stand alone rule would not only benefit investors, because it will focus on these products, but it would also bring some clarity to the fund managers themselves as to what rules appropriately do apply to their funds. Quite often, the fund managers for closed-end funds are left to extrapolate from rules for mutual funds when making decisions and improved guidance for their specific product could be of great assistance.

We also believe a stand-alone rule would be the best mechanism for "borrowing" other important regulatory protections found in NI 81-102 to help better regulate non-redeemable investment funds such as:

▪ *Voting Rights* - We agree that fund investors should have voting rights similar to those outlined in NI 81-102 relating to fundamental changes. Although many retail investors may not exercise their right to vote, they should receive a management information circular outlining the change proposed and be given the opportunity to vote.

▪ S*elf-dealing restrictions* - We agree that self-dealing restrictions should be consistent across all investment funds offered to retail investors, since the potential conflicts that may arise as a result of self-dealing are the same, whether for a mutual fund or another type of investment fund. We see absolutely no justification for not applying the self-dealing rules across all investment fund types. Those rules are fundamental to the protection of investors.

▪ *Custodianship* - We are in agreement that non-redeemable investment fund assets should be subject to custodianship requirements in the same manner as open end mutual funds are subject to those requirements.

C. Commodities and Derivatives

Although the CSA intends to publish for comment proposed amendments relating to investment restrictions for funds in 2013, including additional flexibility for physical commodities and new derivatives, we include our comments here in advance of that comment period.

We believe that the CSA should consider allowing greater access to investments in physical commodities by mutual funds. We think that they are misunderstood as an asset class and the potential benefits to investors are also misunderstood in the current NI 81-102 regime. In our view, the CSA should consider allowing mutual funds to invest a portion of their assets in exchange traded funds or derivatives where the underlying interest is a physical commodity. In addition, we urge the CSA not to wait until 2013 to address this issue, since ultimately investors would have to wait until 2014 or even 2015 before being allowed to benefit from this asset class.

(i) Commodities

A key benefit of investing in commodities as an asset class is improved portfolio diversification. Commodities have historically generated returns that tend to exhibit low correlation relative to the returns for traditional equity and bond investments, as the supply and demand fundamentals of commodities are not directly tied to the demand for these other financial assets. As a result, adding commodities to a diversified portfolio can potentially improve the risk-adjusted returns of the portfolio as well as potentially decrease overall portfolio volatility.

In addition, investing in commodities as an asset class has historically proven to be beneficial in certain market environments. For example, commodities have historically outperformed equities and bonds during times of rising inflation, as commodity prices have historically risen when inflation is increasing. As other asset classes may decline during inflationary periods, having the option to opportunistically allocate a portion of a fund’s assets to commodities may help a fund and its investors preserve capital and maintain purchasing power in an inflationary environment.

However, investing in commodity stocks (that is, equities of issuers engaged in an industry involving one or more commodities) does not provide the same benefits as gaining more direct exposure to physical commodities through Exchange Traded Funds (“ETFs”) or derivatives. Commodity stocks are typically more highly correlated to the broader equity market than commodities are themselves, which reduces the diversification benefits discussed above. Commodity stocks are typically affected by a number of variables other than the price of the commodity they are producing, and therefore may not directly track the price of the commodity. For example, many commodity companies hedge some or all of their commodity production in the futures markets, which reduces or effectively eliminates the company’s exposure to movements in the price of the underlying commodity. The stocks of commodity producers may also be affected by their capital structure, management and business-related activities. The correlation (and diversification) benefits discussed above that are applicable to commodity investing are thus reduced in the case of investments in commodity producers as opposed to physical commodities.

Having the option under NI 81-102 of allocating a portion of a mutual fund's assets to commodities will thus increase diversification opportunities and improve the fund's overall risk/reward profile. Reduced access to commodity markets results in the diminished ability of the portfolio managers to diversify the portfolio and to mitigate other economic risks.

By loosening the NI 81-102 restrictions on investing in commodities and commodity-based ETFs and/or derivatives, mutual funds will thus be able to gain exposure to the benefits of this asset class through highly liquid investments.

(ii) Derivatives

Generally, it is our view that it is time to review the NI 81-102 requirements that govern the use of derivatives to ensure they support the product development needs of the mutual fund industry and investors, as well as the tactical investment needs of portfolio managers. While we are encouraged by the Phase 1 proposed changes to derivatives requirements (i.e. expanding the definition of "cash cover" and eliminating the term to expiry provisions in Part 2.7 (1)), we find that certain other requirements that apply to specified derivatives could benefit from greater guidance.

For example, under NI 81-102 Part 1.1, in order to comply with the definition of a "hedge", a specified derivative position must have "a high degree of negative correlation between changes in the value of the investment or position … being hedged and changes in the value of the instrument or instruments with which the investment or position is hedged". Interpretations as to what constitutes a "high degree of negative correlation" vary in the industry and additional regulatory guidance on applicable thresholds would be appropriate.

We thank you for the opportunity to comment on the proposed amendments. As always, we are more than willing to meet with you to discuss any of our comments.

Yours truly,

W. Sian Burgess

W. Sian Burgess
Senior Vice-President, Head of Legal and Compliance, Canada

c.c. Rob Strickland, President
Fidae Abbas, Director Compliance
Tom Phillips, Manager, Compliance

APPENDIX "A"

COMMENTS ON ISSUES FOR CONSIDERATION RELATING TO MODERNIZATION OF NATIONAL INSTRUMENT 81-102

A. Liquidity

The NI 81-102 liquidity requirements govern a core mutual fund principle: investors should be able to redeem mutual fund securities on demand. However, NI 81-102's current definition of an illiquid asset (an asset that "cannot be readily disposed of through market facilities on which public quotations in common use are widely available") captures securities that are, in fact, liquid and that do not otherwise impair the fund's ability to satisfy redemption requests. In our view, this security-based definition is cumbersome and does not suitably address a mutual fund's need to fund redemptions on demand.

If under the definition one presumes that the dealer market for bonds is a "market facility", "public quotations" in this market are not in "common use" or "widely available" when compared to auction markets for equities. Based on the current requirement it would thus be reasonable to conclude that bonds traded in the dealer market should be considered illiquid, but this outcome is clearly not practical (i.e. bond funds would exceed the illiquid threshold limits under NI 81-102, Part 2.4). Similarly, securities that trade in an institutional market (i.e. those issued under U.S. 144A provisions) may be liquid relative to a mutual fund's need to satisfy redemptions, but the "market facility" and "quotations" are not "widely available". All 144A securities may thus be rendered illiquid under the definition, when they may in fact be more liquid than securities that meet the liquidity criteria.

To eliminate this security-specific approach, the NI 81-102 liquidity provisions should, in our view, be amended with a focus on ensuring a mutual fund is able to fund redemptions. In doing so, mutual fund managers will need to continue to assess liquidity on a per-security basis, but will also need to assess liquidity based on the size of each security position in a fund and trading volumes in the market to properly determine a fund's ability to dispose of the position. This is not currently contemplated in the existing provisions.

B. Fund of Fund Structures

Fidelity Canada has developed a number of mutual fund and pooled fund products that use a fund-on-fund structure. In the interest of expanding the selection of products available to investors we recommend that certain requirements under NI 81-102 Part 2.5 be amended to allow for greater flexibility in the use of fund-on-fund product structures with respect to three different areas: a) multiple layered fund-on-fund structures, b) the use of Canadian pooled funds in fund-on-fund structures, and c) the use of non-Canadian investment funds in fund-on-fund structures.

a) Multiple Layered Structures

Under NI 81-102, Part 2.5 (2)(b) a mutual fund is not permitted to purchase a security of another mutual fund if the other mutual fund holds more than 10% of its market value in securities of other mutual funds. Fidelity Canada and other market participants use this structure but are constrained in the ability to further diversify fund-on-fund products as a result of this restriction. This restriction also impacts Fidelity Canada where it has entered into an advisory relationship with a third-party mutual fund manager and these clients are not able to make use of available mutual fund products that exceed the 10% threshold thus reducing the client's ability to effectively diversify their portfolios.

b) Pooled Funds

Under NI 81-102, Part 2.5 (2)(a) a mutual fund is not permitted to purchase a security of another mutual fund unless the other fund is subject to NI 81-101 and NI 81-102. As such, mutual funds are precluded from investing in pooled fund products. However, we believe that there are a number of different factual scenarios where an investment by a NI 81-102 fund in securities of a pooled fund should be allowed in order to enhance a manager's ability to diversify a fund-on-fund portfolio, potentially in a more cost effective manner than would otherwise be the case using other mutual funds.

c) Use of Non-Canadian Funds

As an international asset management firm, Fidelity Canada has access to global portfolio management expertise and research as well as a comprehensive suite of investment products. However, under NI 81-102 Part 2.5 (2) (c) mutual funds are not permitted to invest in securities of another mutual fund unless they are qualified for distribution in the local jurisdiction. Restricting access to other investment products available within the Fidelity enterprise reduces opportunities to diversify in a cost effective manner.

Fidelity Canada considers the above noted requirements under NI 81-102 Part 2.5 could be liberalized to permit fund-on-fund structures that are more cost effective, can be administered efficiently, and facilitate diversification. However, Fidelity also believes that such liberalization must be balanced by requirements to prevent the duplication of fees, ensure that adequate disclosure is provided to investors, and that the use of any non-Canadian funds is subject to the Canadian fund manager's fiduciary responsibility to investors.