



RBC Global  
Asset Management

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August 22, 2013

British Columbia Securities Commission  
Financial and Consumer Affairs Authority  
of Saskatchewan  
Ontario Securities Commission  
New Brunswick Securities Commission  
Nova Scotia Securities Commission  
Superintendent of Securities, Northwest  
Territories  
Superintendent of Securities, Nunavut

Alberta Securities Commission  
Manitoba Securities Commission  
Autorité des marchés financiers  
Superintendent of Securities, Department  
of Justice and Public Safety, Prince Edward  
Island  
Securities Commission of Newfoundland  
and Labrador  
Superintendent of Securities, Yukon

Attention:

The Secretary  
Ontario Securities Commission  
20 Queen Street West, 19<sup>th</sup> Floor, 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 and Mesdames:

**Re: Proposed Amendments to National Instrument 81-102 *Mutual Funds*,  
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**

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We are writing to provide our comments on 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* (“**NI 81-104**”) and Securities Lending, Repurchases and Reverse Repurchases by Investment Funds (collectively, the “**Proposal**”).

RBC Global Asset Management Inc. (“**RBC GAM**”) is a wholly-owned subsidiary of Royal Bank of Canada and provides a broad range of investment management services and solutions to investors across Canada, including through a variety of mutual funds. As at December 31, 2012, RBC Global Asset Management Inc. had over \$125 billion in Canadian mutual fund assets under management.

We support the Canadian Securities Administrators’ (“**CSA**”) aim of enhancing investor protection and market efficiency by providing a more consistent regulatory framework in key areas for different types of investment funds, while still maintaining appropriate regulatory variations depending on the structure of the investment fund.

Our comments relate to the following aspects of the Proposal:

- A. the proposed amendments to NI 81-102 that impact mutual funds (i.e., we will not comment on the proposed amendments to NI 81-102 that relate to non-redeemable investment funds, as RBC GAM does not currently manage these types of funds);
- B. the proposals relating to NI 81-104 and the creation of a more comprehensive alternative funds framework; and
- C. the proposals relating to enhanced disclosure requirements with respect to securities lending, repurchases and reverse repurchases.

#### **A. Proposed Amendments to NI 81-102 that Impact Mutual Funds**

Our only comment with respect to the proposed amendments to NI 81-102 that impact mutual funds relates to the naming convention proposal. Specifically, we question whether it would be helpful to investors to require investment funds that use only the conventional investment strategies permitted in NI 81-102 to include identifiers in their names that would identify them as such. We similarly question whether it would be helpful to investors to require investment funds regulated under NI 81-104 to include the words, “Alternative Fund”, or some variation thereof, in their names to differentiate them from investment funds subject only to NI 81-102.

Requiring funds to include in their names an identifier in an attempt to flag whether the funds are “NI 81-102 funds” or “NI 81-104 funds” may be too simplistic of an approach to express the differences amongst these different types of funds in a meaningful way. We do not think that most investors, simply by seeing that a fund has been named as an “alternative” or “81-104” fund, or as a “conventional” or “81-102” fund (or some variation thereof), would appreciate the true nature of the fund or be in a position to compare it to other funds bearing a different identifier. Flagging for investors in a fund’s name that the fund is subject to NI 81-102 or NI 81-104 assumes that an investor will be

aware of the requirements of these instruments, which we submit would rarely be the case.

Moreover, dichotomizing investment funds into “alternative” versus “conventional” naming categories risks causing investors to overlook the fact that there is often significant variation in the types of investment objectives, strategies and risks amongst “NI 81-102 funds”, just as there will be significant variation in the types of investment objectives, strategies and risks amongst “NI 81-104” funds. Further, while some “NI 81-104” funds may differ from “NI 81-102 funds” in only very minor aspects, other “NI 81-104 funds” could differ in a much more significant way. None of this variation can be captured – and potentially more concerning, increases the risk of this variation being overlooked – by requiring such naming conventions.

For these reasons, we do not believe that it would be beneficial from an investor’s perspective for funds to be required to use “alternative” versus “conventional” naming conventions. Rather, we believe that it would be more useful for each fund to provide investors with meaningful and prominent disclosure of the fund’s key investment objectives, strategies and risks in its disclosure documents, and for non-conventional funds to highlight for investors in a prominent manner the extent to which the fund’s investment restrictions and strategies may differ from those used by conventional mutual funds.

#### **B. Proposals Relating to NI 81-104 and the Creation of a more Comprehensive Alternative Funds Framework**

We support the CSA’s proposal to redesign NI 81-104 to expand the instrument to include investment funds that wish to use alternative strategies that would go beyond the parameters of NI 81-102. We support the creation of a more consistent set of rules and guidelines to govern alternative strategies. We believe that all investors will benefit from having access to a wider array of investment choices, including investment funds that focus on alternative asset classes or that use alternative strategies not permitted by NI 81-102.

Alternative investment solutions which employ a wider range of investment tools to generate returns and/or reduce volatility have been increasingly used by institutions globally to improve their investment returns and manage risk. The use of such strategies can effectively reduce overall levels of portfolio volatility while allowing exposure to solutions which may improve expected returns with reduced correlations. Retail clients can benefit from access to a broader range of tools, which can effectively improve investment efficiency over time when employed in a portfolio setting.

Within the context of modern portfolio theory, putting a wider variety of investment tools at the disposal of investors can help them to more efficiently deploy capital. We believe that retail investors should, with appropriate levels of information, be able to make use of these tools to improve the risk reward profile of their portfolios.

RBC GAM, as a manager of both conventional mutual funds governed by NI 81-102 and alternative investment funds that are not subject to the restrictions of NI 81-102, welcomes the opportunity to comment on what constraints would be appropriate for alternative funds that could be offered under a revised NI 81-104. Set out below are our comments on the specific issues relating to NI 81-104, for which the CSA has requested feedback, in the same order in which they are listed in Annex B to the Proposal.

We also recognize that the CSA's proposals relating to alternative strategies are at an early stage, and we would be happy to provide continuing feedback to help create an alternative investment fund regime that is in the best interests of investors and efficient capital markets. We look forward to the CSA publishing for comment more specific proposals relating to a revised NI 81-104 for the industry's consideration.

*1. Definition of "Alternative Fund"*

Please see our discussion under Part A, above, regarding why we do not think that investment funds regulated under NI 81-104 should be required to include the words, "Alternative Fund", or some variation thereof, in their names to differentiate them from investment funds subject only to NI 81-102. Establishing clear criteria is a positive step towards establishing a common definition of "alternative funds".

*2. Concentration Restriction – Appropriate Threshold*

We recommend that alternative funds be permitted to exceed the current 10% issuer concentration limit contained in NI 81-102. We think it would be appropriate for an alternative fund to be permitted to invest up to 30% of its net asset value in a single issuer and, perhaps as an additional control, to limit an alternative fund to investing no more than 50% of its net asset value, in aggregate, in holdings that exceed 10% of the fund's net asset value. Expanding the concentration restrictions in this manner would provide alternative funds with a greater ability to closely track appropriate benchmarks whose holdings may exceed the 10% issuer concentration limit set out in NI 81-102.

*3. Concentration Restriction – Measurement*

We support basing issuer concentration for alternative funds on the total notional exposure for the fund. We believe that total notional exposure provides a transparent and more accurate measure of issuer concentration than that provided by other methods.

*4. Borrowing*

We recommend that an alternative fund be permitted to borrow up to a limit of 100% of NAV of the fund at the time of borrowing. Reducing the constraints on borrowing can be beneficial to investors where tactical opportunities to increase exposures past 100% may be additive to performance. Such an expansion would also allow for the

development of a wider array of solutions employing both long and short strategies to improve potential performance metrics. Expanding an alternative fund's ability to borrow, while providing proper disclosure of the limits on borrowing, will provide investors with an appropriate level of choice that is currently not available to them today. We also believe that open-ended alternative funds can be managed such that they should still be able to meet redemption requests even were they permitted to borrow up to a limit of 100% of NAV.

#### *5. Short Selling*

We think that NI 81-104 should 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 recommend that the aggregate market value of securities of any one issuer that may be sold short by an alternative fund should be limited to 20% of the NAV of the fund and that the aggregate market value of all securities that may be sold short by an alternative fund should be limited to 100% of the NAV of the fund. Such limits would enable an alternative fund to for instance, implement "market neutral strategies", which target beta-neutral positions through the shorting of an equivalent amount of securities that the fund holds in long positions. Achieving a beta-neutral position implies lower levels of risk for funds using such strategies notwithstanding that the funds may use higher levels of shorting and leverage. Allowing strategies to fully hedge out their long positions through equivalent short positions may also allow managers to tactically reduce portfolio volatility where they see potential downside risks to the market. Where properly disclosed, the addition of a tool which allows for the establishment of a fully beta neutral position would, in our view, be a positive development for investors. Limiting the aggregate market value of all securities that may be sold short by an alternative fund to 40% of NAV of a fund would reduce the ability of investors to access such strategies.

We agree with the CSA's recommendation that alternative funds be exempt from the short selling conditions in subsections 2.6.1(2) and (3) of NI 81-102, which require funds to hold cash cover and prohibit the use of short sale proceeds to purchase securities other than securities that qualify as cash cover. Such exemptions would facilitate the operation of "120-20" funds. We think it is in investors' interests to have access to funds implementing these types of strategies, if suitable, as they provide higher levels of potential alpha without substantially increasing the funds' risk in relation to their relative benchmarks. Alternative funds should be permitted to use long positions in the funds' portfolios as cover for their short positions.

#### *6. Leveraged Daily Tracking Alternative Funds*

We have no comments on the CSA's proposals relating to leveraged daily tracking alternative funds.

## *7. Counterparty Credit Exposure*

We do not think it would be appropriate to repeal the Counterparty Exposure Exemption from NI 81-104. We think that maintaining this exemption would enable alternative funds to operate more efficiently, and that requiring the posting of collateral by a counterparty should help to mitigate counterparty exposure. An example of an operational efficiency that would likely not be available to alternative funds under a regime where the Counterparty Exposure Exemption was unavailable is alternative funds' use of clearing brokers. Many alternative funds use clearing brokers to help settle derivatives trades and net out exposures to what would otherwise be multiple counterparties. In this arrangement, the clearing broker acts as a counterparty to the fund and provides significant simplification with respect to negotiations with and monitoring of executing parties. It may also be difficult, given the relatively small size of the Canadian market and the challenges that Canadian alternative funds may face in accessing large numbers of counterparties, for alternative funds to observe a 10% counterparty exposure limit. We also note that the potential advent of a central clearing facility for over-the-counter derivatives may eventually reduce the relevance of the 10% counterparty exposure limit; however, until such a clearing facility exists, an exemption from this exposure limit will be important for the efficient operation of alternative funds.

## *8./9.Total Leverage Limit*

We support the CSA's suggestion that a total leverage limit be imposed on alternative funds in NI 81-104. While the proposed level of absolute leverage at 3 to 1 is an appropriate starting point, it is important to ensure that overall levels of risk remain acceptable at the portfolio level. We believe that it may be appropriate to measure leverage in conjunction with net exposure where strategies may look to achieve gross leverage levels in excess of 3 to 1. A limitation of net leverage (such as limiting net market exposures in a leveraged portfolio) where leverage exceeds 3x may be appropriate; however, it may also be appropriate to examine Value at Risk measures to limit overall portfolio risk in leveraged environments.

The use of leverage allows managers of alternative funds to both enhance returns tactically and to reduce risk through the use of shorting to minimize beta exposures. It is in the best interests of investors to have choice expanded to include these types of tools in their portfolios.

## *10. Other Investment Restrictions for Alternative Funds*

We encourage the CSA to consider including in an expanded NI 81-104 the following additional exemptions from the restrictions in NI 81-102:

- Investments in mortgages and loan syndications/loan participations – We recommend that alternative funds be exempted from paragraphs 2.3(b) and (c) of NI 81-102 to permit alternative funds to invest up to 100% of their

net asset value in non-guaranteed mortgages and an unlimited amount in guaranteed mortgages. We also recommend that alternative funds be exempted from paragraph 2.3(i) of NI 81-102 to permit alternative funds to invest up to 100% of their net asset value in loan syndications or loan participations (without regard to whether the fund would assume any responsibilities in administering the loan). These exemptions would enable alternative funds to provide retail investors with loan and mortgage fund solutions that currently are available only on a private placement basis. As an example, RBC GAM has long operated a privately-offered mortgage fund that holds non-guaranteed mortgages. This solution has never experienced a default and has provided consistently higher spreads to investors than a conventional guaranteed mortgage investment over time. RBC GAM believes therefore that it would be in all investors' interests to have access to these types of investment solutions, where suitable.

- Illiquid assets – We recommend that alternative funds be exempted from the restrictions contained in Section 2.4 of NI 81-104 to permit alternative funds to invest up to 20% of their net asset value in illiquid assets.
- Investments in other mutual funds – The CSA has indicated that they are considering permitting a “top” alternative fund to invest in underlying investment funds (including underlying alternative funds) subject to similar conditions applicable to fund-of-fund investments in Section 2.5 of NI 81-102, including the condition that an underlying mutual fund hold no more than 10% of its net asset value in securities of other mutual funds (the “underlying fund 10% restriction”). We do not think that it is in the best interest of investors in alternative funds to only permit “top” alternative funds to invest in underlying mutual funds that in turn hold no more than 10% of their net asset value in securities of other mutual funds. Such a restriction would prevent alternative funds from utilizing many types of efficient and effective multi-tier investment structures. We believe that investors in alternative funds should have access to such multi-tier alternative fund structures, which can deliver the benefits of (1) greater portfolio diversification at a reduced cost relative to that which could otherwise be achieved were the top fund required to invest directly in securities held by the underlying funds; (2) more favourable pricing and transaction costs on portfolio trades, increased access to investments and better economies of scale that can be achieved when the top fund invests through underlying funds; and (3) overall reduced portfolio complexity and increased administrative ease, which results in efficiencies that can be passed on to investors in the top funds. In our view, the above-noted advantages outweigh regulatory concerns regarding the potential complexity of the structure and duplication of fees, which can be appropriately addressed through disclosure and restrictions on duplication of fund fees and costs.

- Use of derivatives – We support the CSA’s proposal to maintain the current exemption from sections 2.8 and 2.11 of NI 81-102 in NI 81-104 to permit alternative funds to create leverage through the use of specified derivatives.
- Physical commodities – We support the CSA’s proposal to maintain the current exemptions from paragraphs 2.3(d) – (g) and (h) of NI 81-102 in NI 81-104 to permit alternative funds to invest in physical commodities and specified derivatives; however, we do not think that these exemptions should be available only to non-redeemable investment funds. We believe that these exemptions should be equally available to open-ended, alternative mutual funds.

#### 11. *On-going Investment by Sponsors*

We think it would be appropriate for sponsors of alternative funds to be subject to the same requirements relating to the maintenance of seed capital investments as those to which sponsors of funds governed by NI 81-102 are subject (i.e., an initial investment of at least \$150,000 by the sponsor and no redemption of seed capital until at least \$500,000 has been received from external investors). To require otherwise would create an uneven playing field between conventional investment funds and alternative funds, and we do not think there is a reasonable basis to have different requirements for alternative funds.

#### 12. *Proficiency*

We do not think that it would be appropriate for the CSA to introduce additional proficiency requirements in NI 81-104 that would apply uniformly to all individual dealing representatives who sell alternative fund securities. Given the potential breadth of alternative funds and the potential for these funds to evolve over time, we think it would be difficult for the CSA to identify a specific course or type of experience that would be appropriate to satisfy know-your-product and general proficiency requirements relating to alternative funds at the dealer level over time. Instead, we believe that it would be more appropriate for each dealer, in conjunction, where applicable, with its governing self-regulatory organization, to develop proficiency standards and procedures with respect to alternative funds that are appropriate given the dealers’ duties to their clients and know-your-product requirements, and that these standards should be flexible enough to enable dealers to adapt to new types of alternative funds that may emerge over time.

#### 13. *Enhanced Disclosure and Transparency*

We have no comments on this aspect of the proposals.




**C. Proposals Relating to Enhanced Disclosure Requirements with respect to Securities Lending, Repurchases and Reverse Repurchases**

We agree with the comments provided by The Investment Funds Institute of Canada (“IFIC”) with respect to these proposals. Namely, we do not think that a fund’s securities lending activity and the revenue generated for a fund is material such that it would influence an investor’s decision whether to buy or continue to hold securities in the fund. As such, we agree with IFIC in questioning the value to investors of having very detailed disclosures about this activity as proposed, and suggest the current general disclosures are sufficient.

Thank you for the opportunity to provide these comments. We would be pleased to discuss with you any of the matters outlined in this letter.

Yours truly,

RBC GLOBAL ASSET MANAGEMENT INC.

By:   
Doug Coulter  
President