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August 23, 2013

BY ELECTRONIC MAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

The Secretary
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-and-

Me Anne-Marie Beaudoin
Corporate Secretary
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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Notice and Request for Comments

We are grateful for the opportunity to provide comments with respect to Phase 2 of the CSA's project to modernize the regulation of publicly offered investment funds (the "**Modernization Project**") and some of the questions set out in the Proposed Amendments to National Instrument 81-102 Mutual Funds ("**NI 81-102**"), Companion

Policy 81-102CP Mutual Funds and 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 (the "**CSA Notice**") and CSA Staff Notice 11-324.

We agree that the Modernization Project is a worthwhile initiative. We generally support the proposed amendments to extend, with necessary modifications, the core operational requirements currently applicable to mutual funds to non-redeemable investment funds (closed-end funds or "**CEFs**"), particularly with respect to the extension of the conflicts of interest provisions of Part 4 of NI 81-102, the securityholder and regulatory approval requirements of Part 5 of NI 81-102, the custodial requirements of Part 6 of NI 81-102, the comingling of cash provisions of Part 11 of NI 81-102, the record date and securityholder record requirements of Part 14 of NI 81-102 and the sales communications provisions of Part 15 of NI 81-102. We agree with the approach to these matters set out in the letter (the "**Bank Letter**") dated August 22, 2013 on behalf of BMO Capital Markets, CIBC, National Bank Financial, RBC Capital Markets, Scotiabank and TD Securities.

In this letter we have focused on the matters identified in CSA Staff Notice 11-324 and some broader issues. We look forward to providing input in the future into the proposed amendments to NI 81-104 (the "**Alternative Funds Framework**") and those matters which inter-relate with the Alternative Funds Framework. We suggest that further consultation before the publication of a proposed rule would be beneficial to the stakeholders and the regulators.

We wish to respond to the following specific questions and general topics for consideration relating to the CSA Notice:

Specific Questions of the CSA relating to the Proposed 81-102 Amendments

1. <u>Annual Redemptions of Securities Based on NAV</u>

Securities legislation defines a "mutual fund" as, among other things, an issuer whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest of the net assets of the issuer.

The CSA have historically taken the view that "on demand, or within a specified period after demand" in the definition of "mutual fund" means that the securities of the fund entitle the holders to request that their securities be redeemed by the fund more frequently than once a year. This view has permitted investment funds to redeem their securities once a year based on their NAV and still be considered non-redeemable investment funds. We seek feedback on whether the CSA should reconsider its present view and consider an investment fund to be a mutual fund if it offers any redemptions based on NAV.

Response:

We think that it would be helpful for the CSA to clarify what is and is not a mutual fund as a definitional matter in order to prevent any confusion in the market. However, we do not believe that there is a substantive basis for reconsidering the CSA's traditional approach that permits CEFs to redeem their securities once a year based on NAV and not be considered mutual funds. We query how this traditional approach is prejudicial to securityholders and we think that it would be unfortunate to eliminate an important design feature for CEFs and deprive investors of this liquidity provision.

2. <u>Investment Restrictions – Introduction</u>

We are providing comments on the proposed investment restrictions not deferred for later consideration by CSA Staff Notice 11-324. However, we have some reservations generally about the proposed approach of mandating investment restrictions for CEFs. Firstly, it is unclear from the CSA Notice what evidence supports the need for such a change. Currently, managers of CEFs in consultation with their advisors including investment bankers and counsel, design products to meet investor needs and preferences, having regard to legal and risk management issues, while taking advantage of market opportunities. The product design includes investment restrictions suitable for the product and its objectives. We are concerned that prescribed investment objectives will inhibit the development of new products which meet investor needs while maintaining an appropriate balance of risks and rewards. We are also concerned that it is not always practical, having regard to timing considerations for bringing a product to market to take advantage of specific market conditions, to seek exemptive relief from proscribed investment restrictions. Finally, without knowing whether the Alternative Funds Framework will present a viable alternative to the proposed regime for CEFs under NI 81-102, it is difficult to comment definitively on the proposed investment restrictions for CEFs.

3. <u>Investment Restrictions – Concentration Restriction</u>

Do you agree with the 10% issuer concentration restriction for non-redeemable investment funds set out in proposed amended section 2.1 of NI 81-102? If not, please provide reasons why non-redeemable investment funds should be permitted to have a higher concentration limit, and how non-redeemable investment funds would benefit from a higher limit. Please also propose a higher limit and provide reasons for the limit.

If NI 81-102 provides for a concentration limit that is greater than 10% for non-redeemable investment funds, should NI 81-104 provide an even higher concentration limit for non-redeemable investment funds that are alternative funds subject to NI 81-104? Or should the concentration limits be the same for non-redeemable investment funds in both NI 81-102 and NI 81-104? We invite feedback on the appropriate balance of the concentration limit in NI 81-102 for non-redeemable investment funds and the concentration limit for non-redeemable investment funds under the alternative funds *framework in NI 81-104.*

Response:

We do not believe that the 10% concentration restriction that currently applies to mutual funds is necessarily appropriate for CEFs. As mutual funds are redeemable on demand, normally daily, such a restriction is useful as a mechanism to maintain liquidity. Because CEFs are not redeemable on demand more frequently than annually, it is not apparent that the extension of this concentration restriction to CEFs serves a fundamental purpose. While the CSA Notice does point out that many CEFs are already subject to a voluntarily imposed 10% concentration restriction, we note that certain of these CEFs impose such as restriction in order to satisfy one of the conditions necessary to qualify as a "mutual fund trust" for the purpose of the *Income Tax Act* (Canada) (while not being a "mutual fund" for securities law purposes) as opposed to reflecting an industry best practice. In addition, we note that the application of such a restriction to all CEFs would impair the ability of CEFs to employ investment objectives and strategies long accepted in the marketplace, including concentration, such as providing exposure to specific industries and sectors, which do not provide opportunities for broad diversification. These funds may be actively managed and therefore would not come within the proposed carve-out for "fixed portfolio ETFs". As a result, we believe that any investment restrictions addressing concentration should not limit investor choice preventing the use of strategies where diversification is not an objective. In any event, we agree that the further consideration of any proposed concentration restriction should take place in the context of the development of the Alternative Funds Framework.

4. Investment Restrictions - Investments in Illiquid Assets

As non-redeemable investment funds do not redeem their securities regularly based on NAV, the CSA propose that they be permitted to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of NI 81-102. However, we are concerned that a portfolio containing a significant amount of illiquid assets could lead to difficulties in valuing the NAV of the fund. It is critical that the NAV of an investment fund be accurately valued; for example, non-redeemable investment funds typically pay management and other fees based on the NAV of the fund, NAV is used to measure performance, and many non-redeemable investment funds offer annual redemptions based on NAV.

We have observed that many non-redeemable investment funds do not invest in a substantial amount of illiquid assets; in fact, the majority of non-redeemable investment funds, like mutual funds, hold minimal amounts of illiquid assets. Would the ability to

purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of NI 81-102 be beneficial for non-redeemable investment funds? What types of illiquid assets do non-redeemable investment funds wish to invest in, and why?

The CSA invite comment on the amount of illiquid assets that would be appropriate for non-redeemable investment funds to purchase and hold, and whether non-redeemable investment funds should be given more time than 90 days to divest illiquid assets (please refer to the mutual fund divestment requirements in subsections 2.4(2) and (3) of NI 81-102). Is there a minimum amount of liquid assets that non-redeemable investment funds should be required to hold to meet ongoing liquidity needs (e.g., to pay management fees and operational expenses)? Should the limit on illiquid asset investments be different for nonredeemable investment funds that do not offer any redemptions and non-redeemable investment funds that offer annual redemptions?

Response:

We recognize that the liquidity risk associated with CEFs is a valid investor protection issue. The IOSCO *Final Report on Principles of Liquidity Risk Management for Collective Investment Schemes* (the "**Report**") published in March 2013 states that the particular objective of liquidity risk management is to allow collective investment schemes (e.g., investment funds) to meet their redemption obligations and liabilities on a timely basis. While the Report recognizes that liquidity and valuation are directly connected, the Report states that valuation concerns should be dealt with through effective and robust valuation arrangements rather than limitations on assets.

CEFs must deal with liquidity risk in order to meet the requirement to pay annual redemptions at NAV (if such redemptions are permitted) and to pay its other liabilities as they come due. The current definition of illiquid assets in NI 81-102 may not properly address this concern.

The first part of the definition of "illiquid assets" in NI 81-102 arguably deals with hard-to-value assets rather than illiquid assets. For instance, an asset can have an easily determinable publicly available price (e.g. due to a listing on a stock exchange) but be difficult to monetize or liquidate in a timely manner because it is very thinly traded or subject to extreme market contraction in stress conditions. Similarly, an asset may have limited public price discovery and yet be easy to monetize at an identifiable price in a wide variety of market conditions (e.g. a position in a senior loan or investment grade bond or bond issued to fund a public infrastructure project). Another example of a highly liquid asset which may be caught by the definition of "illiquid assets" is a security of a mutual fund which is redeemable at NAV daily (as opposed to being disposed of through market facilities on which metric quotations in common use are widely available).

The second part of the definition of "illiquid assets" does deal with actual restrictions on the ability to dispose of an asset, but does not account for the fact that CEFs have (at most) annual redemptions. Therefore, a CEF should not be restricted from investing in assets which have prohibitions on disposal (hold periods) that do not interfere with disposition prior to the due date for paying redemption proceeds.

If the CSA choose to adopt a bright-line restriction on the amount of illiquid assets held by a CEF, such restriction should be based on an updated definition of "illiquid asset" that reflects current market conditions and the particular circumstances of CEFs.

5. <u>Investment Restriction - Borrowing</u>

We seek comment on whether the proposed requirement for non-redeemable investment funds to borrow from a "Canadian financial institution" is appropriate. For example, if the majority of an investment fund's assets are held outside Canada because it focuses on investing in foreign securities, should there be more flexibility to borrow from lenders other than those that are "Canadian financial institutions"? If so, what conditions should the other lenders have to meet?

Response:

We cannot comment fully on any provisions relating to borrowing or other leverage in the absence of an understanding of a proposed Alternative Funds Framework. If limitations on borrowing were to be imposed, we question the proposed requirement to limit the sources of financing available to CEFs to "Canadian financial institutions". The potential benefits of the proposed requirement are unclear and we are not aware of the perceived risks associated with foreign lenders or that foreign lenders would be any less likely to effectively monitor and control the terms of a loan agreement, if that is appropriate consideration for a borrower. The limitation of market competition with respect to a CEF's sources of financing could lead to increased costs of financing which would be ultimately passed along to investors. In addition, we anticipate that the implementation of such a requirement could cause controversy with foreign lenders from a market fairness perspective and pursuant to international trade agreements to which Canada is subject.

While not a question specifically asked in the CSA Notice, we disagree with the proposal to restrict the use of leverage by CEFs to conventional cash borrowing from financial institutions only. We are unaware of any evidence supporting limiting the leverage options available to CEFs, and believe that other disciplines including registration requirements and standards of care applicable to investment fund managers and portfolio managers, the role of investment banks in structuring new CEFs and disclosure requirements applicable to CEFs, provide appropriate safeguards to address any potential concerns regarding types of leverage.

6. <u>Investment Restrictions - Fund-of-Fund Structures</u>

Certain non-redeemable investment funds (top funds) use a forward agreement to obtain exposure to an underlying mutual fund that is not subject to NI 81-102. The underlying mutual fund in this fund-of-fund structure is established solely for the purpose of facilitating the investments of the top fund and it invests in accordance with the restrictions adopted by the top fund.

Under the Proposed 81-102 Amendments, an underlying mutual fund in a fund-of-fund structure would be required to be subject to NI 81-102. The investment restrictions in NI 81-102 applicable to mutual funds are generally more restrictive than the proposed investment restrictions for non-redeemable investment funds. The CSA are considering measures to enable top funds that are non-redeemable investment funds to continue to use the fund-of-fund structure described in the preceding paragraph, such that the underlying mutual fund may continue to invest in accordance with the investment restrictions applicable to the top fund. We seek comment on whether a carve-out from proposed paragraph 2.5(2)(a) of NI 81-102 would be effective for this purpose and if so, what conditions should attach to the use of the carve-out. Are there appropriate alternative measures to enable an underlying fund that is a mutual fund to follow the investment restrictions applicable to the top fund (a nonredeemable investment fund)?

Response:

If fund-of-fund restrictions are imposed on CEFs, we support the proposal that CEFs should be able to obtain exposure to an underlying mutual fund that is not subject to NI 81-102. We believe that a carve-out from s. 2.5(2)(a) of NI 81-102 would be effective to achieve this result and that it would be suitable to make the carve-out conditional on the underlying fund adopting investment objectives and restrictions designed to achieve, either by direct investment or by virtue of the specified derivative by which the CEF obtains exposure to the underlying fund, the investment objectives of the CEF. In addition, such conditions should codify and be consistent with prior exemptive relief granted to mutual funds including commodity pods that implement fund-of-fund structures. We note that the investment objectives and restrictions of the underlying fund will not be identical to those of the CEF. For example, the CEF may have a distribution objective whereas the underlying fund may not pay regular distributions (e.g., partial pre-settlements of the specified derivative are funded by redemptions of securities of the underlying fund). Similarly, the investment restrictions of the CEF may relate to tax issues applicable to the CEF (for example, mutual fund qualification for tax purposes) or issues in connection with the specified derivative.

Currently, many managers of non-redeemable investment funds that invest using the fund-of-fund structure described in question 6 have only filed prospectuses for the underlying fund in Ontario and/or Québec even though the prospectuses for the top fund (the non-redeemable investment fund) were filed in all of the jurisdictions of Canada.

Under proposed amended paragraph 2.5(2)(c) of NI 81-102, the underlying fund must be a reporting issuer in all the jurisdictions in which the non-redeemable investment fund is a reporting issuer. This is intended to prevent an indirect distribution of the securities of the underlying fund in jurisdictions where the underlying fund has not filed a prospectus and to ensure that the local jurisdiction has authority over both the top fund and the underlying fund. Should proposed amended paragraph 2.5(2)(c) apply to non-

redeemable investment funds that use a fund-of-fund structure? If not, why not? What other parameters could be used to address the CSA's objectives?

Response:

To date, the prospectuses of the underlying funds (normally non-offering prospectuses) have been required by the regulators to be filed only in Ontario and/or Québec in order for the underlying funds to become reporting issuers in those jurisdictions and hence subject to NI 81-106. We submit that, if an underlying fund becomes a reporting issuer in at least one Canadian jurisdiction, the objective of making continuous disclosure relating to the underlying fund publically available to investors via SEDAR is satisfied. We do not believe that requiring the underlying fund to become a reporting issuer in all of the jurisdictions in which the CEF offers its securities would enhance investor protection. Instead, it would impose an unnecessary and ongoing cost burden on the underlying fund, negatively impacting returns to investors.

We also question the utility of requiring delivery of the prospectus of the underlying fund to investors in the top fund, as has been required to date, if such a requirement is proposed, since the prospectus of the top fund is required to provide full, true and plain disclosure in respect of the securities acquired by investors. The delivery of a prospectus of the underlying fund imposes additional costs without adding any legitimate benefit.

It is proposed that CEFs not be permitted to invest in other CEFs. We submit that this is an unnecessary restriction. Concerns about leverage and other investment restrictions, if imposed, could be addressed by requiring that any applicable leverage (or other) threshold is calculated on an aggregate basis taking into account leverage (or other requirement) in the top fund and underlying fund.

We note, as referenced in the Bank Letter, that some CEFs have provided exposure to funds that are not reporting issuers. These funds have relied on a long standing practice that, if a portfolio holding constituted less than 40% of a fund's NAV at the time of investment, the offering was not viewed as an indirect offering and, accordingly, the portfolio holding was not required to file a prospectus to become a reporting issuer. We are unaware of any problems arising from this practice and, as a result, see no investor protection benefits to eliminating this practice.

We also note that, if the proposed amendments take effect, CEFs would also become subject to the concentration and control investment restrictions. Accordingly, in order to implement fund-of-fund structures, CEFs would require a carve-out from these investment restrictions. Sections 2.1(2)(c) and 2.2(1.1)(a) currently provide for a carve-out if such investments are made in accordance with the requirements of section 2.5 of NI 81-102 and would likely have to be revised in order to permit CEFs to continue to use the fund-of-fund structure as contemplated in the CSA Notice. It would also be helpful to clarify in Companion Policy 81-102CP that the carve-outs from the concentration and control investment restrictions are available in the case of compliance with the requirements of section 2.5 of NI 81-102, as well as any exemption therefrom provided the terms of the exemption are complied with.

7. Organizational Costs of New Non-Redeemable Investment Funds

We seek comment on the impact and the benefits and costs of proposed subsection 3.3(3) of NI 81-102. Are there other parameters that could be developed that would achieve benefits similar to the benefits from proposed subsection 3.3(3)? Please also comment on whether the capital raising model followed by non-redeemable investment funds could support the payment of some of the organizational costs out of the proceeds of the initial public offering. Are there specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the manager? Please provide information about these cost components and what fraction each component typically constitutes of the total organizational costs for launching a new fund, and explain why it is appropriate for the fund or the manager to pay the specific cost components.

Response:

Proposed subsection 3.3(3) of NI 81-102 would prohibit the costs of organizing a new CEF from being borne by the fund. These would include costs associated with the formation of the fund as well as the preparation and filing of a prospectus and related documents.

The objective of this proposal appears to be to level the regulatory playing field between mutual fund and CEF managers. However, the current prevalent and accepted market practice of CEFs paying organizational costs reflects the fundamental differences between these products. As CEFs are complex, exchange listed products that are offered through a syndicate of investment dealers, the associated costs of launching a CEF are significantly higher when compared to the launch of a mutual fund. Managers must spend considerable effort and costs related to the preparation of the required long-form prospectus, resulting in higher fees from their lawyers, the dealers' lawyers, their accountants, translators, printers, and prospectus filing fees. These products, unlike mutual funds, also incur listing fees. In comparison, the costs of forming a new mutual fund and preparing a simplified prospectus and annual information form are generally a fraction of the costs of a new CEF (in the simplest example, a new mutual fund can be launched by an amendment to an existing simplified prospectus).

Another stated purpose of the proposed prohibition is to better align the interests of managers and investors by shifting the financial risk associated with the launch of a CEF from the investors to the manager. However, CEF managers today face financial risk in several ways. CEF managers are already ultimately responsible for the organizational expenses in the event of a failed transaction, most of which are incurred before it is possible for the manager to determine if the deal has enough traction to proceed. In addition, the general industry practice imposed by the dealer syndicate is that offering expenses borne by a CEF must be capped at 1.5% of gross proceeds of the IPO. Managers bear any additional costs themselves.

The CSA believe the proposal will result in increased cost efficiency, on the theory that if fund managers are required to bear the organizational costs, they would have an incentive to keep organizational costs to a minimum. In addition, the CSA note that launching a larger fund may be more cost efficient than launching multiple smaller funds. We concur with the later statement, and our experience has been that issuers and dealers will not permit a CEF to continue its initial public offering until it has met a critical mass of at least $20 million in sales. However, we note that a large proportion of the organizational costs of a CEF are outside of the manager’s control. These fees (such as those set out above) are either fixed (such as filing and listing fees) or relatively fixed and would be unlikely to change substantially in the event they were to be paid by the manager instead of the CEF. We respectfully submit that it is already in the managers’ interest to keep organizational costs down, because that will result in an IPO of securities with a higher NAV and additional assets with which to implement the fund’s investment strategy from the start.

Another fundamental difference between CEFs and mutual funds is that CEFs are usually distributed in a single offering, meaning that investors are on an equal footing and no particular group of purchasers is prejudiced by the fund paying the offering expenses from its IPO proceeds. In contrast, because mutual funds are in continuous distribution, the prohibition on bearing organizational costs only protects the initial investors.

The CSA note that this proposal may discourage regulatory arbitrage. The example provided is the launch of a CEF with a planned conversion to a open-end mutual fund after a period of time (e.g. 12 to 24 months). We do not believe that such conversions represent a significant segment of the market. To the extent such conversions are viewed by the CSA as problematic, there are other potential regulatory solutions, such as requiring a minimum period of time before such conversions would be permitted or repayment of organizational expenses if conversions occur before that time.

The CSA recognize that the proposed change would impact the ability of smaller managers to launch new CEFs and that not all managers would be able to independently finance organizational costs. If the changes as proposed were implemented, it would likely reduce the number of CEFs brought to market. The CSA have stated that both investors and managers benefit from the introduction of new funds. It is unlikely that investors would have an alternative means to access the strategies offered by innovative CEF products without the associated cost (which could be substantial if an investor tried to replicate a CEF's investment strategy on their own) or at all in the case of strategies available only to institutional investors.

Investors in these CEFs will ultimately receive the primary and significant benefit of access to increased investment opportunities. We suspect that if managers were required to fund all of the substantial costs of a new CEF up front, it could lead to a significant increase in the management expense ratio of these CEFs. While managers are perceived by some to benefit initially if the CEF pays its own start up expenses, provided the managers maintain management fees in line with the existing fees and industry norms, the cost savings to the manager in the initial period after the launch of a CEF could very well be balanced by historically lower management fees over the long term. Also notable is that while mutual fund managers bear the organizational costs of launching new funds, they generally recover their costs from investors over time through deferred sales charges (and potentially higher management fees over the life of the fund).

The long-form prospectus for CEFs prominently disclose that the initial expenses of the CEF are paid by the fund, and these, and ongoing fees of the fund, can be scrutinized and compared by investment dealers and their clients prior to any investment decision being made. The fees, like the investment strategy set out in the prospectus, are part of the initial bargain made between the investors (with the assistance of their highly competent and regulated investment dealers) and the issuer.

8. <u>Transition Period for Investment Restrictions in Proposed Amended NI 81-102 and Alternatives</u>

We are proposing that existing non-redeemable investment funds be required to comply with the investment restrictions in proposed amended sections 2.2, 2.3,1 2.4 and 2.5 of NI 81-102 18 months after the first coming-into-force date of the Proposed 81-102 Amendments pertaining to these sections. We invite feedback on whether the proposed transition period is sufficient. If not, please provide reasons for a longer transition period or provide alternatives to a transition period.

If you think that a grandfathering provision is warranted for existing non-redeemable investment funds, please comment on the scope of a grandfathering provision and explain why existing non-redeemable investment funds should not have to comply with specific sections in Part 2 of NI 81-102. Please also comment on the impact a grandfathering provision could have on fairness to new market participants and investor understanding.

Response:

We submit that a grandfathering provision should apply to all existing CEFs if the proposed amendments are adopted. The complex logistics and substantial costs associated with compliance (and the potential wind-up or conversion of existing CEFs that may not qualify for "alternative fund" status) could be extremely problematic (including, for example, if securityholders did not vote in favour of changes necessary to implement the amendments), particularly as such fundamental changes would be at odds with the bargain originally struck between existing CEFs and investors and would be inconsistent with prospectuses that have already been receipted by CSA members. Furthermore, to counteract the uncertainty which currently exists in the market created by the proposed amendments, we believe it is imperative that the CSA announce now that it will grandfather (particularly with respect to investment restrictions) CEFs created prior to the time proposed changes take effect.

Questions of the CSA Relating to the Alternative Funds Framework in NI 81-104

We strongly support the CSA's proposal to develop an Alternative Funds Framework by amending NI 81-104 to include both mutual funds and CEFs that focus on alternative asset classes or use alternative investment strategies not permitted under the proposed amended NI 81-102 (such funds being referred to herein as "**Alternative Funds**"). As the CSA Notice did not include specific language for the proposed amendments to NI 81-104 and the specific questions of the CSA relating to the Alternative Funds Framework in Annex B to the CSA Notice relate primarily to the operational aspects of Alternative Funds, we will restrict our comments at this time to more general comments regarding the Alternative Funds Framework.

1. <u>General Comments</u>

We believe that the objective of the Alternative Funds Framework should be to provide Canadian investors with access to as broad an array of investment strategies as possible so that they may construct truly diversified investment portfolios. By their very nature, Alternative Funds will pursue a multitude of investment strategies with the goal of enhancing returns to investors. Furthermore, these strategies are constantly evolving and new strategies and techniques are being developed by the managers of Alternative Funds. There appears to be a presumption in the CSA Notice that Alternative Funds, by their very nature, are inherently more risky than NI 81-102 conventional mutual fund investment strategies. Although this may be true for certain Alternative Fund investment strategies, it is not true for all. The Alternative Funds Framework should, to the greatest extent possible, accommodate this vast array of strategies and enable the development of new strategies within acceptable risk parameters for retail investors. In order to accomplish this objective, we strongly encourage the CSA to adopt a principles-based (as opposed to prescriptive) approach to the Alternative Funds Framework. We suggest that this can only be accomplished following a period of public consultation and dialogue with industry participants so that the CSA can fully understand the impact that limits on such matters as concentration, borrowing, short selling, leverage and other investment restrictions placed on Alternative Funds may have on industry participants and investors.

2. <u>Specific Comments</u>

Although we cannot comment definitively in the absence of more concrete proposals for the Alternative Funds Framework, we would also like to make a few specific preliminary comments with respect to some of the elements of the Alternative Funds Framework contained in the CSA Notice:

Organizational Costs/Ongoing Investment by Sponsors

We refer you to the section of this comment letter relating to the organizational costs for CEFs and we apply those comments to Alternative Funds under the amended NI 81-104. We also do not believe that the sponsors of Alternative Funds should be subject to more onerous requirements than sponsors of conventional mutual funds relating the amount or maintenance of seed capital investment as this could create a significant barrier to entry for Alternative Funds and we are unaware of a defensible basis for such a distinction.

Proficiency

Consistent with our support for a principles-based approach to the Alternative Funds Framework, we do not support the imposition of additional proficiency requirements for individual dealing representatives who sell securities of Alternative Funds. We note that dealers are already subject to "know your product" obligations as part of the suitability requirements under section 13.3 of NI 31-103. We would submit that these provisions are sufficient to ensure that anyone selling Alternative Fund products has the required proficiency to deal in such securities. In addition, the variety of strategies which may be utilized by Alternative Funds would make it extremely difficult to prescribe a specific course or level of experience. In the absence of any specific proposed proficiency requirements, we cannot comment on how additional proficiency requirements for the sale of the securities of Alternative Funds would enhance investment protection. To impose additional proficiency requirements for dealing representatives would only serve to restrict the potential channels through which Alternative Fund products may be sold and limit the access that Canadian investors would have to such products.

Naming Convention

We question any requirement for alternative funds to include the words "Alternative Fund" in their name. To do so could result in all Alternative Funds being classified in the same manner when, in fact, there is a much broader array of investment strategies used in Alternative Funds compared to conventional mutual funds. Such classification could unnecessarily result in restricted access to distribution channels if the term "Alternative Fund" was automatically associated with a higher risk profile. We would suggest that the better way to distinguish Alternative Funds from conventional NI 81-102 mutual funds would be to include prominent disclosure on the front page of the prospectus of the Alternative Fund as well as any marketing materials of the Alternative Fund that the fund is subject to NI 81-104 and, as such, may pursue investment strategies which are not permitted for funds subject to NI 81-102. The disclosure should encourage investors to carefully review the prospectus of the Alternative Fund and to only make an investment decision following consultation with their professional advisors.

Fund-of-Fund Structures

We do not agree with the CSA's proposal in the CSA Notice that Alternative Funds wishing to use a fund-of-funds structure may only invest in underlying mutual funds (including underlying Alternative Funds) that are reporting issuers in the same jurisdictions as the Alternative Fund. We submit that NI 81-04 should include an exemption which would permit an Alternative Fund using the fund-of-funds structure to invest in underlying mutual funds which are reporting issuers in certain recognized foreign jurisdictions (e.g., the United States or United Kingdom) or domestic funds which are either: (i) reporting issuers in at least one Canadian jurisdiction or (ii) offered under prospectus exemptions in Canada provided that the underlying fund has redemption/liquidity provisions which are consistent with the redemption/liquidity requirements for the top fund. To only permit funds which invest in or obtain exposure to such underlying funds to be offered only in reliance on discretionary relief orders would increase the costs of structuring such funds and restrict the ability of Canadians to obtain exposure to a broader array of investment products.

Concluding Remarks

We appreciate the opportunity to submit our comments on behalf of members of the Investment Funds and Asset Management Group at McMillan LLP. Please do not hesitate to contact any of Michael A. Burns at (416) 865-7261, Jason A. Chertin at (416) 865-7854, Stephen Genttner at (416) 865-7023, Margaret McNee at (416) 865-7284, Shahen Mirakian at (416) 865-7238, or Kimberly J. Poster at (416) 865-7890, should you require further information.

Yours truly,

"*McMillan LLP*"