Manulife Asset Management

December 22, 2016

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

C/O:

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

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
consultation-en-cours@lautorite.qc.ca

Dear Mesdames/Sirs,

Re: Canadian Securities Administrators' Notice and Request for Comment - Modernization of Investment Fund Product Regulation – Alternative Funds

Manulife Asset Management Limited is pleased to have the opportunity to provide comments on the Canadian Securities Administrators' ("**CSA**") Notice and Request for Comment – Modernization of Investment Fund Product Regulation – Alternative Funds (the "**Proposed Amendments**").

Capitalized terms used in this letter but not defined here have the same meaning given to them in the Proposed Amendments.

Overview

Founded in 1949, Manulife Asset Management Limited ("**MAML**") provides a range of investment fund products and a range of services including acting as portfolio manager and investment fund manager. These products and services may be provided in the name of MAML, and/or one or more of its divisional trade names for external clients, including Manulife Asset Management and Manulife Investments ("**MI**").

Manulife Asset Management entities provide comprehensive asset management solutions for institutional investors and investment funds in key markets around the world. This investment expertise extends across a broad range of public, private, and alternative asset classes, as well as asset allocation solutions. Manulife Asset Management has offices with full investment capabilities in the United States, Canada, the United Kingdom, Japan, Hong Kong, Singapore, Taiwan, Indonesia, Thailand, Vietnam, Malaysia, and the Philippines. In addition, it has a joint venture asset management business in China, Manulife TEDA. It also has operations in Australia, New Zealand and Brazil. Manulife Asset Management Private Markets has investment expertise in several private asset classes, including commercial real estate, timberland and farmland, renewable energy, oil and gas, private equity and mezzanine debt. Manulife Asset Management Private Markets also partners with Manulife's specialized private asset investment teams to invest in private placement debt and commercial mortgages. Hancock Natural Resources Group, Manulife Real Estate, John Hancock Real Estate, NAL Resources, Regional Power, Manulife Capital, and Hancock Capital Management are units of Manulife Asset Management Private Markets.

As at September 30, 2016, assets under management for Manulife Asset Management were approximately C$450 billion.

Manulife Investments, a division of Manulife Asset Management Limited, builds on 125 years of Manulife's wealth and investment management expertise in managing assets for Canadian investors. As one of Canada's leading integrated financial services providers, Manulife Investments offers a variety of products and services including mutual funds, non-redeemable investment funds and structured products, and separately offers banking and insurance products through its affiliates.

As of September 30, 2016, Canadian mutual fund assets for Manulife Investments were approximately C$49 billion.

General Observations

We agree with the CSA that "the Proposed Amendments, if adopted, will have a meaningful impact on publicly offered mutual funds that utilize alternative strategies or invest in alternative asset classes (alternative funds) and would also affect other types of mutual funds (namely conventional mutual funds and ETFs) as well as non-redeemable investment funds", and are strongly supportive of efforts to modernize Canada's regulatory framework for investment funds and bring increased investment options to Canadian retail investors.

Although our primary comments are with regards to eligible asset classes and appropriate proficiency requirements, we are responding in turn to each of the questions posed by the CSA, as well as adding a select few other recommended improvements, as particularized below.

The questions are reproduced in bold for ease of review.

<u>Definition of "Alternative Fund"</u>

1. Under the Proposed Amendments, we are seeking to replace the term "commodity pool" with "alternative fund" in NI 81-102. We seek feedback on whether the term "alternative fund" best reflects the funds that are to be subject to the Proposed Amendments. If not, please propose other terms that may better reflect these types of funds. For example, would the term "non-conventional mutual fund" better reflect these types of funds?

Manulife AM Comment: We are supportive of the term "alternative fund", and note that it is similar to the term "alternative investment fund" used in the European Union for the regulation of a range of non-traditional fund asset classes, including hedge funds, commodity funds and real estate funds. This would be distinct from investment products using more traditional investment strategies to invest in stocks, bonds and/or or cash.

We are similarly supportive of the CSA's decision not to impose a naming convention for alternative funds that would require the use of "alternative fund" in the fund name.

As a further technical item, we agree with the comments made by the Alternative Investment Management Association ("**AIMA**") in recommending the following drafting clarifications to the proposed definition of "alternative fund":

"alternative fund means a mutual fund**<u>, other than a precious metals fund,</u>** that has adopted fundamental investment objectives that permit it to invest in asset classes**<u>,</u>** ~~**or adopt**~~ **<u>use</u>** investment strategies **<u>or implement operational features that are not permitted by this Instrument</u>** ~~**that are otherwise prohibited**~~ but for **<u>certain</u>** prescribed exemptions ~~**from Part 2 of**~~ **<u>contained in</u>** this Instrument;"

<u>Investment Restrictions</u>

Asset Classes

2. We are seeking feedback on whether there are particular asset classes common under typical "alternative" investment strategies, but have not been contemplated for alternative funds under the Proposed Amendments, that we should be considering, and why.

Manulife AM Comment: We believe for the reasons below that both direct real property and non-guaranteed mortgages are common under typical alternative investment strategies and recommend they be made eligible investments under the alternative fund framework.

One solution may be to allow investors to access to these asset classes within the illiquid limits for alternative funds, while also allowing funds dedicated to these asset classes (e.g., "real estate funds") to have higher exposure and be subject to a different set of conditions. This latter concept would be similar to the ability of a precious metals fund under the Proposed Amendments to expose itself more broadly to commodities than other types of alternative funds.

Another option may be to allow for greater exposure to these alternatives, with more flexible illiquid limits, within an alternative fund of alternative funds and/or a multi-asset alternative funds (i.e., an alternative fund with multiple strategy 'sleeves', rather than multiple underlying funds).

Any alternative fund focused on direct real estate, mortgages, or other more illiquid assets would need higher illiquid limits, similar to the higher limits extended to Canada's segregated funds and remaining mutual funds in these categories.

In making these recommendations, we are cognizant that higher illiquidity brings higher risk of suspension of redemptions[1], as well as of Canadian regulatory efforts to treat funds with "active involvement" in the assets of the fund as non-investment funds[2]. In our view, neither of these points are sufficient to warrant blocking Canadian retail investors from making an informed decision to accessing these asset classes in alternative funds, or in alternative funds of funds, when suitable to their investment needs.

a. **<u>Real Property</u>**

The three primary arguments in favour of direct real estate are:

i. **Improved Diversification:** A key benefit of investing in real property as an asset class is improved portfolio diversification. This asset class has 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 real estate are not directly tied to the demand for these other financial assets. As a result, adding exposure to real property to a diversified portfolio can potentially improve the risk-adjusted returns of the portfolio as well as potentially decrease overall portfolio volatility.

   We also note that investing in real estate stocks (that is, equities of issuers engaged in the real estate industry) <u>does not</u> provide the same benefits as gaining more direct exposure to real property. Real estate stocks are typically more highly correlated to the broader equity market than real property assets are themselves, which reduces the diversification benefits discussed above. Real estate stocks are typically affected by a number of variables other than the value of the real property assets they are developing, holding, operating or managing, and therefore may not directly track the value of the real property assets. For example, the stocks of real estate companies may be affected by their capital structure, management and business-related activities.

ii. **Inflation Protection:** Investing in real property as an asset class has historically proven to be beneficial in certain market environments. For example, real estate has

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[1] Please see our responses to question 5 for a brief discussion on tools that can help mitigate liquidity risk.

[2] For example, section 1.2 of Companion Policy 81-106 reads that "...an investment fund does not seek to invest for the purposes of exercising or seeking to exercise control or being actively involved in the management of any issuer". Active involvement has been interpreted in ways including focussing on the originator's sourcing efforts, property management, etc.

been positively correlated with rising inflation, as real estate valuations have historically risen when inflation is increasing. As other asset classes may decline during inflationary periods, having even the option to opportunistically expose a portion of a fund's assets to real property may help the fund and its investors preserve capital and maintain purchasing power in an inflationary environment.

iii. **Potential Performance Enhancement:** For the reasons discussed above, the option of allocating even portion of a fund's assets to direct real property will not only increase diversification opportunities but can also improve the Fund's overall risk/reward profile.

In considering whether real estate might be appropriate in an alternative fund, we made the following further observations regarding access to real estate by Canadian retail investors, as well as retail investors abroad:

iv. **Exemptive Relief under NI 81-102 – Investors Real Property Fund:** Canadian securities regulators, including the OSC, have previously granted extensive relief from the provisions of NI 81-102 in order to permit a Canadian retail mutual fund governed by NI 81-102, namely the Investors Real Property Fund managed by I.G. Investment Management, Ltd., to directly purchase, hold, manage and operate a portfolio of real property (see *I.G. Investment Management, Ltd. (April 18, 2007)* and *I.G. Investment Management, Ltd. (May 26, 2009)*).

According to the fund's 'fund facts' dated September 26, 2016, this fund appears to have been operating at least as early as January 1984 (almost 23 years), and had assets of $5.5 billion as at July 31, 2016. It is clear based on public disclosure documents that many of the retail mutual funds managed by I.G. Investment Management, Ltd. have invested significant portions of their net assets in securities of the Investors Real Property Fund and that, as a result, a significant number of the issued and outstanding securities of the Investors Real Property Fund are in aggregate held by those retail funds. For example, the Alto Monthly Income Portfolio, a fund-of-funds product managed by I.G. Investment Management, Ltd., discloses in its fund facts dated September 26, 2016 that 9.9% of its assets were invested in securities of the Investors Real Property Fund as at July 31, 2016, and that it generally provides 10% exposure to the Investors Real Property Fund.

In our view, this fund's 20+ years demonstrates that the needs of retail Canadians can be served within an investment fund regulatory framework inclusive of appropriate guidelines, and would be supportive of further similar offerings being allowed as alternative funds only.

v. **Exempt Market - Canadian Real Estate Pooled Funds:** Real estate fund offerings can generally be made to 'mass affluent' individual Canadians who are not accredited investors or otherwise exempt, but who rely on the offering memorandum exemption in section 2.9 of NI 45-106. This would include "eligible investors" whose net assets alone or with a spouse exceed $400,000, or whose net income exceeds $75,000, or a net income of $125,000 with a spouse. While the requirements of this exemption vary by Province and Territory, conditions of reliance on this exception generally include the provision of an offering memorandum in a prescribed format and the signing of a risk acknowledgement.

Regulators are encouraged to consider the alternative funds framework as an opportunity to further standardize and enhance disclosure and other obligations for real estate funds (e.g. independent review committee oversight), similar to the prospectus-qualified Investors Group fund discussed above.

vi. **Real Estate is Permitted for Canadian Individual Retail Segregated Fund Policy Holders:** Any Canadian who cannot access a diversified portfolio of direct real estate in a mutual fund or pooled fund can do so in a segregated fund[3], though they may not want or need the insurance guarantee features these products can provide.

vii. **Real Estate Investment Flexibility was Increased in Canadian Pension Rules:** Recognizing the benefits real estate can offer to pension plans, pension regulators in recent years eliminated the real estate investment quantitative limits formerly in s. 10 of Schedule III of the *Pension Benefits Standards Regulations, 1985.*

viii. **Many European Retail Investors Can Invest in Real Estate Funds:**

In many European jurisdictions, real property is a common asset class to be held in funds available to retail investors. Examples of unlisted vehicles for retail investors where the primary investment strategy is to invest in property include[4]:

France

France allows investment by individuals in real estate collective investment undertakings (*Organismes de Placement Collectif Immobilier* or "**OPCI**") – unlisted property investment vehicles managed by authorised fund managers and which are set up as either a company or a real estate fund. There are no restrictions on the type of investor. OPCIs are governed by the French monetary and financial code (MFC) implementing the Alternative Investment Fund Managers Directive ("**AIFMD**") into French law and the General Regulation of the *Autorité des Marchés Financiers*). Because they are open to retail investors, OPCIs are subject to specific rules, notably in terms of eligible assets, risk limits and investment ratios. In addition, there are provisions for the marketing and sales to retail investors, such as the obligation to provide key investor information, prospectus and annual reports.

Germany

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[3] See Canada Life and Health Insurance Association Inc. *Guideline G2 – Individual Variable Insurance Contracts Relating to Segregated Funds* (the "**CLHIA Guidelines**"), sections 9.1 and 9.5.

[4] With thanks to Ashurst LLP for their European investment law research on point.

Germany allows investment by individuals in investment funds including open-ended and closed-ended real estate funds. There no restrictions on the type of investor but limits on the assets and real estate companies that may be acquired in accordance with the German Capital Investment Code ("**KAGB**") or AIFMD as well as on leverage and risk spreading. In addition, there are provisions for the marketing and acquisitions with regard to retail investors in accordance with KAGB/AIFMD, e.g., duty to provide the retail investor with key investor information, prospectus and annual reports as well as publication duties and ongoing information duties.

Luxembourg

Luxembourg similarly allows investment by retail individuals in "Part II Funds" – collective investment undertakings subject to the Part II of the Luxembourg "2010 Law". Interests in Part II Funds can be sold to any type of investor, i.e. institutional, high net worth and retail investors. These funds must comply with diversification investment restrictions (generally five different investments), and requirements to prepare detailed constitutional and offering documents and an annual report. The fund and all the fund documentation is subject to prior Commission de Surveillance du Secteur Financier approval and ongoing supervision.

Spain

Spain similarly allows investment by retail individuals in a real estate investment fund or company (*Fondos de Inversión Inmobiliaria, Sociedad de Inversión Inmobiliaria* or "***FII – SII***"). There are no restrictions on the type of investor in a FII or SII as specifically designed for retail investors. Restrictions are placed upon its investment strategy, and risk diversification. NAV must be calculated at least monthly, and participations can be subscribed or redeemed at least once a year.

United Kingdom

Broadly, the UK allows investment by individuals in retail investment funds that invest primarily in direct property (and other illiquid assets) in 'Non-UCITS retail schemes' ("**NURS**") managed by authorised fund managers. There are no restrictions on the type of investor in a NURS as specifically designed for retail investors. Restrictions are placed upon its investment strategy, including a limit on the percentage of assets that can be held in one investment (full restrictions set out in the Collective Investment Schemes Sourcebook Chapter 5).

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Again – if retail investors can access direct real estate in an unlisted real estate fund in these countries, we encourage the CSA to consider similarly allowing direct real estate in an alternative fund in Canada, subject to appropriate conditions.

b. **Non-Guaranteed Mortgages**

As many of our arguments in favour of non-guaranteed mortgages replicate our arguments for real estate, we offer them in brief followed by additional information regarding the Canadian commercial mortgage market generally.

An ability to accessing these mortgages directly can improve income diversification, as well as returns, and the performance of these mortgages is not the same as guaranteed mortgages (the returns are generally higher as a further risk premium is earned relative to mortgages with government guarantees) or any listed mortgage vehicle (the performance of which will be more directly impacted by the performance of the broader market).

Canadian retail investors looking for commercial mortgage fund exposure are facing diminishing investment fund options, as only existing NI 81-102 funds meeting the grandfathering exceptions of s. 20.4 of NI 81-102 can be offered, with the Proposed Amendments narrowing mortgages in non-redeemable investment funds even further. As a result, they may need to look to either (a) the exempt market; or (b) mortgage segregated funds that offer guarantees they may not need[5].

Similar to real estate, we believe non-guaranteed mortgages are an appropriate class for consideration in an alternative fund framework, and that Canadian retail investors should be able to benefit from, where suitable.

General Information regarding Canadian Commercial Mortgage Market

The Canadian commercial mortgage market provides a source of financing for real estate properties in Canada across a diverse group of property types and geographic regions. Commercial mortgage issuance is predominately investment grade however it spans across the full credit quality spectrum.

Terms to maturity generally range from 1 year to over 10 years with amortization periods ranging from fifteen to thirty years with twenty-five years being the most common and some interest only loans on a case by case basis. Loan repayments are received on a monthly basis for the term of the mortgage, most often in a blended form of principal and interest with the outstanding principal balance due at the end of the mortgage's term.

The leading participants in the commercial mortgage market include primarily banks, insurance companies, pension funds, conduit lenders, credit unions and private groups. Lenders either source investment opportunities from borrowers directly or through the mortgage brokerage community.

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[5] Please see sections 9.1. and 9.6 of the CLHIA Guidelines for the rules generally governing mortgage segregated funds offered under individual variable annuity contracts.

Like a bond, a commercial mortgage is a fixed instrument that is used to secure the repayment of a loan for funds advanced to a borrower. Security for these loans is a registered charge against income-producing property. The primary types of income producing assets held as security by commercial mortgage lenders are retail, office, industrial and multi-family properties. Hotels, senior housing facilities, self storage facilities, land and manufactured home communities are less prominent properties that are also used as security for commercial mortgage loans.

The amount of a commercial mortgage available to a borrower is driven by two key ratios: loan-to-value and debt service coverage. Institutional lenders have traditionally lent to a maximum of seventy-five percent of the estimated market value of the property while ensuring that the net operating income generated by the property is sufficient to cover the annual debt service obligations created by the mortgage of a ratio of typically not less than 1.20 times. Adherence to these ratios generally provides certain capital and cash flow downside protection should the property and /or owner, experience unexpected market and /or credit events during the course of the loan's term.

Pricing of a commercial mortgage has two components: the yield on a term-equivalent Government of Canada bond and a credit spread. Historically, commercial mortgage credit spreads have averaged around 150 basis points with the actual spread being a reflection of the strength and quality of the commercial mortgage loan and if applicable guarantor entities, property characteristics (property type, location, tenants, leases, vacancy rate and income), transaction metrics (loan to value and debt service coverage ratios), and prevailing market conditions.

A higher spread or coupon for a commercial mortgage relative to a similarly rated public bond is primarily compensation for the lower liquidity offered by commercial mortgages relative to a public security and often reflects the ability to negotiate terms, structures, and covenants, rather than in an auction process, as is the case in the public bond market. Cash flow is generally fixed rate and closed to prepayment. Prepayments may be accepted with yield maintenance calculated on a discounted cash flow basis typically based upon the Government of Canada bond yield.

Commercial mortgages also generally offer a higher level of security than many other alternative fixed income products. The security behind the majority of bond issues relies on the good faith and credit of the issuer. In the event of a default, bond indentures do not entitle the lender to attach a claim to a specific asset owned by the borrower. Bondholders are considered general creditors, ranking in priority just ahead of common stock holders. Recovering on general creditor debt is dependent on liquidated value of the borrowing entity after all of the secured creditors (including mortgage holders) have been satisfied.

Mortgage lenders, on the other hand, hold a priority charge against specific fixed assets. In the case of a default on a mortgage loan, the lender may look to the borrower (for mortgages that have recourse provisions) as well as the property and its cash flow for repayment, and has a range of mortgage default remedies to help maximize the likelihood of recovering the full amount of the outstanding loan.

Concentration

3. We are proposing to raise the concentration limit for alternative funds to 20% of NAV at the time of purchase, meaning the limit must be observed only at the time of purchasing additional securities of an issuer. Should we also consider introducing an absolute upper limit or "hard cap" on concentration, which would require a fund to begin divesting its holdings of an issuer if the hard cap is breached, even passively, which is similar to the approach taken with illiquid assets under NI 81-102? Please explain why or why not.

Manulife AM Comment: We generally have no objection to a 20% concentration limit for alternative funds, and would not object if no hard cap was imposed, similar to the 10% concentration limit for conventional mutual funds, which has no hard cap.

We further echo AIMA's argument that any hard cap runs the risk of triggering forced sales, "as quickly as commercially reasonable", which may be at times of distressed prices or otherwise not be in the best interests of investors in the fund.

Illiquid Assets

4. We are not proposing to raise the illiquid asset limits for alternative funds under the Proposed Amendments. Are there strategies commonly used by alternative funds for which a higher illiquid asset investment threshold would be appropriate? Please be specific.

Manulife AM Comment: Yes. As noted above, many alternative funds use strategies such as real estate, mortgages, and private debt with higher illiquid limits for investors who have longer time horizons and who can otherwise satisfy their liquidity needs from their other investments and liquid assets.

As noted above, other retail-oriented regimes in Canada and abroad have allowed such products to have different illiquid standards to enable retail clients to have access to such asset classes, subject to appropriate conditions, including liquidity and disclosure obligations.

In support of this point, we echo the facts raised by the Investment Funds Institute of Canada ("**IFIC**")[6], that U.S. conventional mutual funds are allowed to invest 15% of their assets in illiquid assets, which we think Canadian conventional mutual funds should be allowed to follow. We would also encourage higher illiquid limits (up to 20%) in alternative funds.

As a separate point, we separately acknowledge the industry comments on certain technical challenges in the definition of "illiquid asset" in NI 81-102, and in particular encourage adoption of the clarifications being articulated by the Portfolio Management Association of Canada ("**PMAC**"), which revises the definition to:

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[6] For ease of reference, IFIC's submissions include: "We encourage the CSA to consider adopting a higher time of purchase limit for alternative funds. In 1992 the U.S. Securities and Exchange Commission increased the permitted level of mutual fund investments in illiquid assets from 10% to 15% of NAV[6]. At the time U.S. small businesses were finding it increasingly difficult to obtain financing from banks and similar traditional sources. It was felt that allowing mutual funds to invest an additional 5% of their net assets in illiquid securities could make a significant amount of capital available to small business without significantly increasing the risk to any fund. Assessing the experience of U.S. mutual funds over the decades since this limit was increased should provide sufficient evidence that a similar increase for alternative funds in Canada is unlikely to significantly increase the risk to these funds."

"illiquid asset" means:

(a) a portfolio asset that cannot be readily disposed of through market facilities on which public quotations in common use are widely available (which include over-the-counter-markets) at an amount that at least approximates the amount at which the portfolio asset is valued in calculating the net asset value per security of the investment fund;

(b) a restricted security (other than a government or corporate bond) held by an investment fund;

Finally, we acknowledge the CSA's guidance with regards to liquidity that "...[the CSA] continue[s] to stay abreast of the various initiatives on liquidity risk management for investment fund products at the international level and how this may impact our work on this stage of the Modernization Project." (September 22, 2016 OSC Bulletin p.8054; all OSCB page references in this letter are to this bulletin).

As a global asset manager, we strongly encourage global harmonization of appropriate investment fund standards to achieve common levels of investor protection, simplify administration and reduce costs.

5. Should we consider how frequently an alternative fund accepts redemptions in considering an appropriate illiquid asset limit? If so, please be specific. We also seek feedback regarding whether any specific measures to mitigate the liquidity risk should be considered in those cases.

Manulife AM Comment: Yes. Generally, the less frequent redemptions are, the less the liquid needs of the fund in the ordinary course.

Many institutional funds offer access to alternative asset classes at redemption frequencies that are monthly or annual, or have lengthy notice periods for redemption, to seek to maximize potential investment returns in illiquid assets and reduce the risk that assets will need to be liquidated in unfavourable market conditions, or that redemptions may need to be suspended.

Some of the tools used by the funds to help mitigate liquidity risk include leveraging assets or borrowing from lines of credit and other sources.

6. We are also proposing to cap the amount of illiquid assets held by a non-redeemable investment fund, at 20% of NAV at the time of purchase, with a hard cap of 25% of NAV. We seek feedback on whether this limit is appropriate for most non-redeemable investment funds. In particular, we seek feedback on whether there are any specific types or categories of non-redeemable investment funds, or strategies employed by those funds, that may be particularly impacted by this proposed restriction and what a more appropriate limit, or provisions governing investment in illiquid assets might be in those circumstances. In particular, we seek comments relating to non-redeemable investment funds which may, by design or structure, have a significant proportion of illiquid assets, such as 'labour sponsored or venture capital funds' (as that term is defined in NI 81-106) or 'pooled MIEs' (as that term was defined in CSA Staff Notice 31-323 *Guidance Relating to the Registration Obligations of Mortgage Investment Entities*).

Manulife AM Comment: We agree that investors in exchange-traded non-redeemable investment funds have lower liquidity needs from their fund's investment assets relative to conventional mutual funds and alternative funds, as they can sell their fund to another investor on the exchange, rather than only being able to redeem it.

As a result, we agree with industry feedback that the illiquid limits of exchange-traded non-redeemable investment fund can and should be much higher and would be supportive of continuing to have no illiquid limits being imposed on these non-redeemable investment funds.

7. Although non-redeemable investment funds typically have a feature allowing securities to be redeemable at NAV once a year, we also seek feedback on whether a different limit on illiquid assets should apply in circumstances where a non-redeemable investment fund does not allow securities to be redeemed at NAV.

Manulife AM Comment: Yes. Again, generally, if a fund does not have to redeem at a specific asset valuation, there should be a higher tolerance for illiquids.[7]

Borrowing

8. Should alternative funds and non-redeemable investment funds be permitted to borrow from entities other than those that meet the definition of a custodian for investment fund assets in Canada? Will this requirement unduly limit the access to borrowing for investment funds? If so, please explain why.

Manulife AM Comment: We agree with past comments by others "that limiting borrowing to Canadian financial institutions would reduce competition and possibly increase borrowing costs" (OSCB p.8083).

As a factual matter, two of our non-redeemable investment funds currently have borrowing arrangements with a U.S. subsidiary of a Canadian Schedule I bank. The borrowing is denominated in U.S dollars as the borrowed monies are used to buy U.S. securities for primarily U.S. mandates. If the borrowing restriction is implemented as proposed, we will no longer be able to borrow from this lender.

The CSA is aware of the higher qualification requirements for foreign sub-custodians, relative to Canadian custodians, as set out in section 6.3 of NI 81-102. We encourage the CSA to clarify its rationale for restricting behind wanting to restrict borrowing to Canadian lenders, and consider

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[7] We also agree with AIMA's responses to this question, which reads: "Generally speaking, we submit that liquidity is of little relevance or concern where an alternative fund or a non-redeemable investment fund have limited redemptions and of no relevance or concern where such a fund is not redeemable. Our view is consistent with International Organization of Securities Commissions ("IOSCO") principles on liquidity. The alignment of liquidity with the redemption obligations and other liabilities of open-ended funds is a principle recommended in IOSCO's "Principles on Suspensions of Redemptions in Collective Investment Schemes" [available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD367.pdf] and reiterated in a report published in March 2013 entitled "Principles of Liquidity Risk Management for Collective Investment Schemes" in which they recommended fifteen principles [available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD405.pdf.]"

whether any higher requirements for foreign lenders (similar to the higher requirements on foreign sub-custodians) might mitigate these concerns.

In the alternative, if the CSA is unwilling to allow borrowing from lenders globally due perhaps to the perceived risks of borrowing from lenders in certain countries, we encourage the CSA to allow borrowing from U.S. lenders under conditions similar to s.6.2 of NI 81-102.

We note that NI 81-102 already has a number of special provisions for the U.S. inclusive of the definition of "government security" (the government of the United States of America is the only foreign government in this definition) and "index participation unit" (the only permitted foreign exchanges are in the U.S.), and respectfully request that the CSA again consider the U.S. in light of the protections offered by its robust legal and regulatory systems.

As a separate point, we understand many alternative fund strategies (e.g., hedge funds) commonly rely on the services of a prime broker, who may not meet the custody standards in s. 6.2 of NI 81-102. We encourage further analysis to ensure that the rules for alternative funds are sufficiently flexible to access these key service providers, and in particular, to the comments submitted by AIMA on prime brokers.

As a final general borrowing point, we encourage the CSA to consider whether paragraph 2.6(a)(i) might be further expanded for temporary measures to accommodate requests for redemptions of alternative funds and conventional mutual funds. The purpose of reconsidering the paragraph would be to enable the fund to avoid or minimize overdraft or other expenses that may be incurred by the fund in satisfying higher than usual levels of redemption demand.

We understand that other countries such as the United States allow conventional mutual funds to borrow from one another under set conditions to mitigate conflicts, at a competitive rate that is lower than that of custodian overdraft charges, and beneficial to both the lending and borrowing funds. Such interfund lending tools are also desirable as there is no guarantee that custodian overdraft facilities will be available to accommodate redemption needs, particularly in distressed market environments.

To the extent conventional mutual funds are holding relatively more illiquid assets, it would also be useful to offer them the further borrowing tool allowed in *Alphapro Management Inc. (May 29, 2015)*, an exemption which allowed a senior loan fund to borrow cash up to 10% of NAV as a temporary measure to accommodate requests for redemption of units. That relief was granted, subject to numerous conditions, in recognition of the longer settlement times of senior loans.

Total Leverage Limit

9. Are there specific types of funds, or strategies currently employed by commodity pools or non-redeemable investment funds that will be particularly impacted by the proposed 3 times leverage limit? Please be specific.

Manulife AM Comment: We have no comments on this item at this time.

10. The method for calculating total leverage proposed under the Proposed Amendments contemplates measuring the aggregate notional amount under a fund's use of specified derivatives. Should we consider allowing a fund to include offsetting or hedging transactions to reduce its calculated leveraged exposure? Should we exclude certain types of specified derivatives that generally are not expected to help create leverage? If so, does the current definition of "hedging" adequately describe the types of transactions that can reasonably be seen as reducing a fund's net exposure to leverage?

Manulife AM Comment: We are supportive of AIMA's encouragement of the CSA "...to either: (i) remove the 300% of NAV leverage limit from section 2.9.1 and to require disclosure of the amount of leverage and the method used for calculating leverage by the alternative investment; or (ii) allow alternative funds to subtract or disregard certain offsetting or hedging transactions (such as currency hedges) in specified derivatives that do not create leverage."

If the latter, we are also supportive of the recommendations of AIMA, IFIC and PMAC to exclude from leverage calculations any hedging derivative transactions. We are similarly supportive of excluding hedging short sales activities (at least of government securities), and offsetting transactions, to reduce calculated leverage exposure.

We recognize the CSA's comments regarding Value at Risk ("**VaR**") measures, which reads "...although the value-at-risk is quite a comprehensive measure it may not be a straightforward method of calculation and can be somewhat subjective in its elements" (OSCB 8075). As the CSA has indicated it is nonetheless welcoming "specific feedback on appropriate methodologies", we do wish to confirm our willingness to use the Value-at-Risk methodologies that we use abroad for the reasons below as well as part of our desire, as a global asset manager, to efficiently manage these risks consistently across borders.

The following is adapted from submissions made earlier this year by our affiliates, John Hancock Advisers, LLC and John Hancock Investment Management Services, LLC (collectively "**John Hancock Investments**") to the U.S. Securities and Exchange Commission ("**SEC**") regarding *Use of Derivatives by Registered Investment Companies and Business Development Companies.*[8]

> John Hancock Investments recommended the SEC consider "...the adoption of a principles-based risk management framework, in lieu of rigid portfolio limitations. Under this approach, a fund could elect to comply with one of two VaR-based regimes similar to the guidelines applicable to UCITS funds: (i) a Relative VaR approach, pursuant to which the VaR of a fund's entire portfolio may not exceed the VaR of a reference portfolio by greater than a set measure; or (ii) an Absolute VaR approach, pursuant to which the VaR of a fund's derivatives portfolio may not exceed a defined amount...of the fund's net assets under management.
>
> [John Hancock Investments wrote] that the VaR regime is superior to the proposed portfolio exposure limits for several reasons. First, the VaR regime would likely have an even more limiting effect on the ability of registered funds to enter into significant directional leverage than would the portfolio limitations described in the Proposed Rule. Second, a principles-based risk management framework such as the VaR regime does not suffer from the perverse incentives and unintended consequences of the portfolio limitations described

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[8] More specifically, the submissions address the SEC's proposed rule 18f-4 under section 18 of the *Investment Company Act of 1940* (the "**Proposed Rule**").

herein[9]. Third, the VaR regime appropriately distinguishes between derivative transactions that increase portfolio risk and those that reduce portfolio risk. Fourth, rather than assessing the notional exposure of derivatives, which is an imprecise proxy for whether leverage actually increases risk, the VaR regime ***actually assesses the extent to which leverage increases the speculative character of a fund***. In these respects, the VaR regime is both a more effective means of measuring and managing a fund's derivatives risk and more closely related to the undue speculation concern expressed in section 1(b)(7) of the 1940 Act.

[John Hancock Investments recognized] that the VaR regime, considered in a vacuum, does have certain drawbacks. The [SEC] cites as one drawback the difficulty in selecting an appropriate benchmark for a relative VaR test. However, as discussed above, a relative VaR test could be based on endogenous characteristics of a fund's portfolio rather than an external benchmark. If the [SEC] adopts a VaR regime that does not require any reference to an external benchmark, this concern would be entirely moot. The [SEC] also cites as a drawback of the VaR approach the possibility that a fund could obtain enormous offsetting exposures and still pass either VaR test described above. However, we believe this concern is mitigated by the other provisions of the Proposed Rule. The qualifying coverage regime of the Proposed Rule effectively limits this possibility by requiring that a fund earmark a risk-based coverage amount with respect to each derivative transaction entered into by the fund."

We are not recommending any changes to the definition of "hedging" at this time, though would welcome any further calculation clarity to ensure consistent interpretation. For example, we are aware of at least one law firm advising that the definition's requirement of "a high degree of negative correlation" should be taken to mean "approximately 75-80% negative correlation over at least a three-year period".

11. We note that the proposed leverage calculation method has its limits and its applicability through different type of derivatives transactions may vary. We also acknowledge that the notional amount doesn't necessarily act as a measure of the potential risk exposure (e.g. interest rate swaps, credit default swaps) or is not a representative metric of the potential losses (e.g. short position on a futures), from leverage transactions. Are there leverage measurement methods that we should consider, that may better reflect the amount of and potential risk to a fund from leverage? If so, please explain and please consider how such methods would provide investors with a better understanding of the amount of leverage used.

Manulife AM Comment: Like AIMA, we generally agree that the notional amount doesn't necessarily "...reflect the way in which the fund uses the derivative and that it is not a direct measure of risk."

We again echo the comments of John Hancock Investments to the SEC in their submission that:

"...gross notional exposure is rarely an accurate reflection of the market exposure created by a derivative instrument because the cash flow obligations under most derivatives are a small percentage of notional exposure. For example, the volatility of most interest rate derivatives is much lower than the volatility of equity derivatives....

The two most obvious consequences of portfolio limitations based on a simplistic calculation of notional exposure are constraints on the ability of fund managers to (i) reduce or manage the risks of fund

[9] One of the "perverse incentives and unintended consequences" cited included that "...the Proposed Rule may incentivize fund managers to use derivatives with higher risk profiles and lower notional exposure to manage or reduce the risks of fund portfolios in an effort to comply with portfolio limitations..."

> portfolios through the use of derivatives (particularly derivatives with low volatility profiles), and (ii) use derivatives to obtain synthetic exposure to securities or other assets. Reducing the risk management options available to fund managers will result in portfolios with higher risk profiles. Likewise, the impact of limiting or removing the ability to express investment strategies through synthetic exposures in fund portfolios is a lost opportunity to reduce risks related to liquidity, valuation, and transparency that can arise from holding certain physical positions. It is possible that the portfolio limitations in the Proposed Rules will reduce risks in certain portfolios that engage in directional leverage, but they will also increase risk in portfolios of funds that use derivatives for risk management and risk reduction. In other words, for funds employing low risk investment strategies, the Proposed Rule as written effectively reduces risk management options for funds which may decrease the fund's expected return or increase its risk to achieve that level of return."

We would be pleased to share our affiliates' entire submission to the SEC upon request.

Our views in support of VaR are outlined in response to question 10.

Interrelated Investment Restrictions

12. We seek feedback on the other Interrelated Investment Restrictions and particularly their impact on non-redeemable investment funds. Are there any identifiable categories of non-redeemable investment funds that may be particularly impacted by any of the Interrelated Investment Restrictions? If so, please explain.

Manulife AM Comment: We have no comments on this item at this time for non-redeemable investment funds, beyond those we have made elsewhere in this letter.

Disclosure

Fund Facts Disclosure

13. Are there any other changes to the form requirements for Fund Facts, in addition to or instead of those proposed under the Proposed Amendments that should be incorporated for alternative funds in order to more clearly distinguish them from conventional mutual funds? We encourage commenters to consider this question in conjunction with proposals to mandate a summary disclosure document for exchange-traded mutual funds outlined in the CSA Notice and Request for Comment published on June 18, 2015.

Manulife AM Comment: Similar to past releases of proposed fund facts documentation, we strongly encourage the CSA to issue a sample fund facts for alternative funds to review and comment on. The development of such a sample often yields insights to practical challenges in document development or investor experience that may not otherwise be obvious, and serves as further helpful guidance to the industry on regulatory expectations.

In the interests of keeping the Fund Facts brief and readable, we also believe there should be no Fund Facts disclosure obligation to contrast alternative funds with conventional mutual funds. A Fund Facts for an alternative fund should inform investors by telling them what it is, without having to tell them what it is not. Also, in furtherance of our response to Question 14 below, we would discourage any mandated disclosure implying a blanket "high risk" for all alternative funds regardless of the risk level of the particular fund described in the Fund Facts.

14. It is expected that the Fund Facts, and eventually the ETF Facts, will require the risk level of the mutual fund described in that document to be disclosed in accordance with the CSA Risk Classification Methodology (the Methodology) once it comes into effect. In the course of our consultations related to the Methodology, we have indicated our view that standard deviation can be applied to a broad range of fund types (asset class exposures, fund structures, manager strategies, etc.). However, in light of the proposed changes to the investment restrictions that are being contemplated, we seek feedback on the impact the Proposed Amendments would have on the applicability of the Methodology to alternative funds. In particular, given that alternative funds will have broadened access to certain asset classes and investment strategies, we seek feedback on what modifications might need to be made to the Methodology. For example, would the ability of alternative funds to engage in strategies involving leverage require additional factors beyond standard deviation to be taken into account?

Manulife AM Comment: While standard deviation is not without shortcomings, we are supportive of using standard deviation for alternative fund risk classification as a consistent methodology across all investment funds.

We are currently reviewing the final risk rating methodology guidance published December 8, 2016, and still considering its applicability to alternative funds, but note IFIC's comments that:

> "There is much more work to be done before the [final risk rating] methodology [released on December 8, 2016] can be applied to alternative funds. For instance, the Canadian Investment Funds Standards Committee ("CIFSC") currently has only one general "catch-all" category for funds that apply "alternative strategies". This is due primarily to the current heterogeneity of the investment strategies applied by those funds, making it difficult to compare one fund with its peers. IFIC's Fund Categorization Working Group is considering the best categorization approach to recommend to CIFSC for these funds. It is our hope that fund managers not apply their own individual criteria to the alternative funds they manage. Similarly, as the CSA has already acknowledged, applying a blanket classification of "high risk" to all of these funds, without further analysis, is inappropriate."

One area that we will be particularly focused on is the "use of discretion", which "...only allows a fund manager to classify a mutual fund at a higher investment risk level than indicated by the quantitative calculation", and questioning whether some further interim flexibility is warranted for alternative funds.

Different types of alternative funds can have meaningfully different risk and return characteristics, not only relative to each other, but in isolation over time. We encourage the CSA to ensure the final version of the Proposed Amendments includes clear rules regarding the use of the CSA's risk classification methodology for alternative funds. This would permit alternative fund managers to adopt the CSA's risk classification methodology at the outset, rather than having to switch methodologies and disclosure after the first alternative funds Fund Facts have been filed and delivered.

Point of Sale

15. We seek feedback from fund managers regarding any specific or unique challenges or expenses that may arise with implementing point of sale disclosure for non-exchange traded alternative funds compared to other mutual funds that have already implemented a point of sale disclosure regime.

Manulife AM Comment: We have no comments on this item at this time.

Transition

16. We are seeking feedback on the proposed transition periods under the Proposed Amendments and whether they are sufficient to allow existing funds to transition to the updated regulatory regime? Please be specific.

Manulife AM Comment: We have no objections to the proposed transition periods.

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Other Comments

In addition to our comments above, we respectfully submit the following additional comments:

1.**Ability of Conventional Funds to Only Invest 10% in Alternative Funds**

The CSA noted that the proposed amendments help facilitate more alternative and innovative strategies while at the same time maintaining restrictions believed to be appropriate for products that can be sold to retail investors. With this in mind, the CSA has proposed a conventional mutual fund's aggregate exposure to alternative funds is limited to 10%.

We respectfully submit that, to help encourage conventional retail funds' access to innovative strategies, consideration should be given to increasing the limit up to 20%. This increase is particularly desirable for an investor seeking exposure to asset classes and/or investment strategies through portfolio solutions rather than stand-alone mutual funds.

2. **Mutual fund dealer salesperson proficiency requirements for alternative funds**

In the Proposed Amendments, the CSA advised it "...will be working with the MFDA to come up with the best solution to [appropriate proficiency requirements for mutual fund dealer salespersons] ..., have not proposed any changes to the proficiency requirements for IIROC registrants..., [and]...welcome any specific feedback on the Proficiency Requirements in light of the Proposed Amendments" (this, and all subsequent quotes in this section, are from OSCB p. 8078- 8079).

While we place high value on appropriate registrant proficiency to help deliver investor protection, we note with concern, that one past commenter to the CSA had suggested that "…the CSA should consider Chartered Financial Analyst, Chartered Investment Manager or Chartered Alternative Analyst designation as proficiency standards for representatives dealing in alternative funds".

We hope to see retail Canadians be able to appropriately take full advantage of the new investment options that alternative funds can deliver, when suitable to their needs. As a result, we respectfully encourage careful consideration of appropriate proficiency levels for mutual fund dealer salespersons, to ensure these levels are not needlessly raised to a point that effectively restricts much retail investor access to alternative funds.

In considering the appropriate proficiency requirements, we noted the following:

a. *Conventional Mutual Funds Can do Most Things an Alternative Fund Can*

Under the Proposed Amendments, most of the differences in investment 'tools' between a conventional mutual fund and alternative funds are differences in the extent to which a particular strategy can be used, as opposed to whether they can be used at all.

For example, alternative funds are allowed higher limits for concentration restrictions, commodity investments, investments in underlying alternative funds, shorting and more flexibility in derivative usage.

As we presume these existing investment tools in conventional mutual funds are able to be well understood within existing proficiency requirements, we see no justification to materially increase proficiency requirements merely because these tools are being more significantly used.

As there are many similarities between conventional funds and alternative funds, we suspect existing investment fund courses could be updated to include alternative funds content. That said, we appreciate existing mutual fund salespersons will need training on alternative funds including how they are different from other types of funds.

b. *Mutual Fund Dealer Salespersons Are Trained in the Risks of Borrowing and Leverage*

The starkest differences between conventional and alternative funds are the strategies that generally conventional funds cannot do at all, namely borrowing and leverage. We recognize the significant extent to which these two tools can be used in alternative funds, which can have a very meaningful impact on fund performance.

We believe all mutual fund dealer salespersons should already have a strong understanding that such tools can magnify investment gains or losses, as part of their training on the risks of borrowing to invest. As a result, we do not believe significant additional proficiency requirements are warranted to understand these tools in an alternative funds context.

c. *"Know your Product" Reviews of Alternative Funds likely to be More Robust*

We believe alternative funds will generally be more complex in nature than conventional mutual funds, and will warrant further know your product ("**KYP**") scrutiny to ensure proper understanding. MFDA guidance on KYP expectations for alternative funds may further mitigate any perceived need for material additional proficiency requirements.

d. *Significant Additional Proficiency Requirements Can Significantly Limit Distribution Channels*

Though MAML has never offered commodity pools, there is a general belief within our Product and Legal teams that part of the reason why so few firms offered commodity pools was because of the significant additional proficiency requirements for mutual fund sales representatives and their supervisors in Part 4 of NI 81-104.

In brief, under NI 81-104, the sales representative would have to pass any of the Canadian Securities Course, Derivatives Fundamentals Course, Chartered Financial Analyst ("**CFA**") Program, or a proficiency standard set by a self-regulatory organization. Other courses commonly taken by mutual fund dealer salespersons, such as the Canadian Investment Funds Course Exam or the Investment Funds in Canada Course Exam, would not suffice.

The supervisor has the relatively tougher standard to meet in that they have to either pass the Derivatives Fundamentals Course or CFA program.

As many salespersons and/or their supervisors did not have these courses, and for whatever reason did not obtain them, this undoubtedly impacted access to commodity pools, which in turn impacted the number of commodity pools launched and assets raised.

We looking forward to reviewing the proposed proficiency requirements for alternative funds in due course.

3. **Conventional Funds - Derivatives – "Designated Rating"**

The CSA's counterparty risk commentary in the Proposed Amendments (OSCB p.8071) included a recognition that "there are now fewer counterparties that...meet the "designated rating" threshold" set out in NI 81-102.

We agree that there are fewer counterparties meeting this threshold following the global financial crisis, and respectfully recall past law firm notifications from 2011 about prominent financial institutions such as Bank of America, Goldman Sachs, Citigroup, Morgan Stanley and Merrill Lynch & Co. Inc. each being downgraded by one or more designated rating organizations to below the designated rating threshold for long-term debt set out in NI 81-102, and therefore being - at least temporarily until their ratings improved - ineligible as counterparties for longer-term derivatives.

To access a wider array of counterparties and ensure robust competition, while still addressing counterparty risk by ensuring the counterparty is investment grade, we recommend considering aligning the definition of "designated rating" in NI 81-102 with the definition of "designated rating" in NI 44-101.

For ease of reference, under NI 81-102, "designated rating" means, "...for a security..., a rating issued by a designated rating organization, or its DRO affiliate, that is at or above one of the following rating categories, or that is at or above a category that replaces one of the following rating categories, if:

(a) there has been no announcement by the designated rating organization or its DRO affiliate of which the mutual fund or its manager is or reasonably should be aware that the rating of the security or instrument to which the designated rating was given may be down-graded to a rating category that would not be a designated rating, and

(b) no designated rating organization or any of its DRO affiliates has rated the security or instrument in a rating category that is not a designated rating:

Designated Rating Organization	Commercial Paper/ Short Term Debt	Long Term Debt
DBRS Limited	R-1 (low)	A
Fitch, Inc.	F1	A
Moody's Canada Inc.	P-1	A2
Standard & Poor's Ratings Services (Canada)	A-1 (low)	A"

By contrast, under NI 44-101, "designated rating" means, "...for a security, a rating by a designated rating organization, or its DRO affiliate, that is at or above one of the following rating categories or that is at or above a category that replaces one of the following rating categories [ratings for preferred shares excluded]:

Designated Rating Organization	Short Term Debt	Long Term Debt
DBRS Limited	R-2	BBB
Fitch, Inc.	F3	BBB
Moody's Canada Inc.	Prime-3	Baa
Standard & Poor's Ratings Services (Canada)	A-3	BBB"

The CSA will appreciate in comparing the two definitions that the latter definition not only includes lower investment grade thresholds, and requires only one qualifying rating from a designated rating organization, it also eliminates the obligation to treat potential downgrade announcements by designated ratings organizations as effective.

In the alternative, if the CSA is unwilling to adopt a credit rating as low as BBB, we would be supportive of an NI 44-101 approach that only requires meeting the A or A2 designated rating from at least one designated rating organization.

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Concluding Comments

We believe Canadian retail investors have much to gain from the expanded asset classes and strategies being made available in alternative funds space, and commend the CSA for its efforts in advancing these proposals. That said – we remain hopeful that the asset classes and strategies extended are only an *initial first step* – and that the CSA will grant further access to additional commonly used alternative strategies (e.g., real estate) in the near future, to better enable Canadians to meet their investment needs.

We also trust that there will be careful consideration of appropriate proficiency levels for mutual fund dealer salespersons, to ensure that proficiency levels are not needlessly raised to a point that effectively restricts most retail investor access to alternative funds.

We thank you for your consideration of our comments, and welcome your inquiries in English or French, which can be directed to Warren Rudick (at Warren_Rudick@manulife.com or (416) 852-5338) or Anick Morin (at Anick_Morin@manulife.com or (514) 499-7999, ext. 304491).

Yours very truly,

Manulife Asset Management Limited

Bernard Letendre
Director & President, Manulife Investments

CC: Roger Renaud, *Global Chief Operating Officer and President Canada, Manulife Asset Management*

Kai R. Sotorp, *President & Chief Executive Officer, Manulife Asset Management and Manulife Asset Management Limited*

Anick Morin, AVP & Lead Counsel, Investments, *Manulife Investments*

Warren M. Rudick, General Counsel, *Manulife Asset Management Limited*