

The Secretary
Ontario Securities Commission
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We thank the CSA for the opportunity to provide comments on the proposed changes to NI 81-102 Investment Funds. Lightwater Partners Ltd. is an alternative asset manager based in Toronto. The firm was founded in 2007 and is registered with the Ontario Securities Commission as a Portfolio Manager, Investment Fund Manager, and Exempt Market Dealer.

Background

“The Proposed Amendments are part of the CSA's implementation of the Modernization Project.”

Comment: As part of its “modernization project” the CSA should fundamentally reconsider its approach to regulation. Risk should not be judged on *how* a security or fund is distributed; risk should be judged on *what* is being distributed. The prevailing CSA notion that a prospectus offering is inherently less risky than an Offering Memorandum product is an outdated concept. The \$112 billion dollars lost by Valeant shareholders over the last 15 months is a stark reminder of this point.

Fund-of-Fund Structures

“We are proposing to permit mutual funds (other than alternative funds) to invest up to 10% of their net assets in securities of alternative funds and non-redeemable investment funds, provided those underlying funds are subject to NI 81-102.”

Comment: Mutual funds are managed by sophisticated professionals who are skilled in assessing risk. These professional Portfolio Managers do not need the same protections that may apply to retail investors. Hence, Portfolio Managers should be able to invest in non-NI 81-102 compliant funds.

Further, we do not understand the logic of restricting such investments at 10% of NAV. Given that risk analysis, measurement and assessment are fundamental competencies of Portfolio Managers in Canada, there is no reason why a Portfolio Manager should not have the option to put up to 100% of a portfolio in investment funds. To impose a “bright line” standard of a 10% investment limit is both arbitrary and unduly restrictive.

Short Selling

“We are proposing to increase the aggregate market value of all securities that may be sold short by an alternative fund to 50% of the NAV of the fund.”

Comment: Liquid alts are designed to bring alternatives to retail investors in a lower risk manner. By limiting short selling at 50% of NAV, the CSA would effectively increase the level of risk in most long/short portfolio strategies – particularly for market-neutral positions, which are one of the most conservative investment strategies. It is ironic that the outcome of the proposal would be the unintended (and unfortunate) consequence that underlying hedge funds would have a lower risk profile than their liquid alt equivalents, even though the former is automatically classified as high risk. We recommend that this limit not be applied to such funds.

“We are also proposing to increase the aggregate market value of all securities of any issuer that may be sold short by an alternative fund to 10% of the NAV of the fund.”

Comment: The CSA proposes to limit short selling at 50% of NAV yet it is willing to allow up to 10% in one short position? Clearly the CSA has little understanding of risk management in a long/short portfolio. This is particularly alarming given that a sizeable portion of the mutual fund Portfolio Managers who may be managing these new alternative funds will have little or no experience in short-selling securities.

Disclosure / Short Selling

“A key element of the CSA's proposal for a more robust framework for alternative funds is to also bring alternative funds into the prospectus regime that exists for other types of mutual funds. Currently, under NI 81-101, all mutual funds, other than commodity pools and exchange listed mutual funds, are required to prepare an SP, annual information form (AIF) and Fund Facts, with the Fund Facts having to be delivered at or before the point of sale. We are proposing that alternative funds that are not listed on an exchange be subject to this disclosure regime.”

Comment: These disclosure proposals seem oblivious to the dangers of disclosing short positions. Unlike a short ‘attack’ on a security, which is limited by a short-seller’s ability to borrow for a stock and to pay stock lending fees, there are no such limitations for a short squeeze. Once other investors become aware of short positions, the danger of a short squeeze is ever-present. This is one of the main reasons why liquid alts have failed to replicate the success of their hedge fund counterparts in Europe and the USA.

Form of Prospectus/Point of Sale

“Given the CSA’s efforts to otherwise harmonize the disclosure regimes for mutual funds, we do not believe that there is a policy basis for requiring that unlisted alternative funds continue to be subject to a different prospectus regime than every other type of unlisted mutual fund.”

Comment: This is an ominous statement concerning the future of the Exempt Market in Canada. Liquid alts are at best a second-rate substitute for hedge funds. It is ironic that to meet the criteria proposed in NI 81-102 we would have to increase the level of risk and reduce the expected return of our hedge funds.

Proficiency

“There are currently no additional requirements for individuals registered as dealing representatives of an investment dealer who are also members of the Investment Industry Regulatory Organization of Canada (IIROC).”

Comment: The strategies employed in liquid alts are as complex as their underlying hedge funds. Hedge funds require special proficiency requirements. Thus the choice is simple: either remove the proficiency requirements for hedge funds, or introduce the same proficiency requirement for liquid alts.

I can be reached at 416 504 9767 x 101 should you require further clarification.

Regards,

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