



LAWRENCE PARK

ASSET MANAGEMENT

December 21, 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 Consumer 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

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

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

Lawrence Park Asset Management Ltd. (“**LPAM**”) 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**”).

LPAM is supportive of the CSA’s ongoing policy work to modernize investment fund product regulation that will include a new category of funds offering investors access to a variety of alternative strategies. While the attractive risk reward profile and diversification benefits available through alternatives are welcome and desirable, we also appreciate that these strategies will expose investors to new risks and that it is important that investor protection also be a core component of the new regulation.

Our Business

LPAM is registered under the Securities Act (Ontario) as a portfolio manager, investment fund manager and exempt market dealer. LPAM currently manages investment funds that offer alternative strategies issued to investors pursuant to certain exemptions from prospectus requirements contained in National Instrument 45-106 *Prospectus Exemptions*. LPAM also has a portfolio management sub-advisory agreement with a number of National Instrument 81-102 *Investment Funds* (“NI 81-102”) mutual funds.

The primary objective of LPAM's alternative investment strategy is to generate positive absolute returns with an emphasis on capital preservation and low correlation to traditional equity and fixed income markets. Our core strategy involves purchasing investment grade corporate bonds on margin from our prime brokers and selling short government bonds to maintain a low duration profile relative to our benchmark index. We target a volatility profile at or below the Canadian TMX Bond Universe, with significantly lower sensitivity to interest rates than traditional fixed income funds. Under the current rules, we are prohibited from offering our core strategy under NI 81-102, because we utilize leverage and short sales of government bonds.

Summary of our Comments

We welcome the Proposed Amendments as an opportunity to allow more investors to gain access to the benefits of various alternative strategies, including relative value fixed income strategies. Such strategies have proven to be efficient diversification vehicles for investors that have utilized them in the exempt market. While it is important that the new framework provide consistency in its regulatory approach, we also believe it is important to ensure the new regulations are not too restrictive on low risk strategies that use different investment vehicles to hedge portfolio risks.

We are concerned that the Proposed Amendments will introduce funds that offer leveraged versions of traditional investment strategies but will make it difficult to introduce funds that offer true alternative strategies with effective hedges in place. Therefore, the Proposed Amendments may provide only limited diversification benefits leading to an increase of risk in the investment fund universe which we don't think is consistent with the CSA's objective.

The current prohibition in NI 81-102 on the use of leverage is only one reason why alternative strategies are currently restricted to the exempt market. The other reasons are due to restrictions that prevent the use of a number of hedging techniques. It is important that the implications of these restrictions be revisited in the Proposed Amendments. These hedging techniques are effective tools to offset the additional risk associated with leverage. In particular, the Proposed Amendments will make it very difficult to offer a relative value fixed income alternative fund. To facilitate the inclusion of our core strategy in an alternative fund, the Proposed Amendments will have to include the flexibility that allows an alternative fund to generate all the permitted leverage through short sales and permit alternative funds to concentrate the short sales in a small number of government issuers.

Below we highlight 5 specific areas where we believe the Proposed Amendments could be improved.

1. Prime Broker Accounts

The prime broker model is a critical component for the efficient operation of alternative strategies and we propose part 6 of NI 81-102 be updated to allow the use of a prime broker by alternative funds. We believe a prime broker should be permitted to act as a custodian for the alternative fund's portfolio assets. In addition, we propose that a prime broker should also be permitted to lend cash and securities to the fund and act as a derivative counterparty. The portfolio assets held by the prime broker will be used as margin for the outstanding borrowings, short sales and derivatives. The prime broker(s) will also need to be exempt from the 10% limit in sections 6.8(1) and (2) and section 6.8.1(1).

One of the consequences of this arrangement is that all portfolio assets including those being used as margin for borrowings, short sales and derivatives will be held with one counterparty, the prime broker(s). However, it is our opinion that the fund's portfolio assets are safer if held in a single (or limited number of multiple) prime broker account(s) than if some of the portfolio assets are held in a custody account and the remaining portfolio assets are held as margin across a large number of borrowing and derivative counterparties. In our analysis, a generic alternative fund levered 2.5 times through the use of short sales and derivatives, operating under the Proposed Amendment's 10% limit on assets deposited as margin at a lending or derivative counterparty, would require the use of 10 counterparties that would in aggregate hold two thirds of the fund's portfolio assets. We haven't included the details of our analysis but they are available to the CSA upon request. We believe this will lead to the use of smaller, higher risk dealers, or foreign counterparties who are not regulated by IIROC. We believe this is not the intention of the Proposed Amendments.

If an alternative fund wants to borrow cash or securities or trade derivatives with counterparties other than their prime broker(s), any portfolio assets deposited as margin with those counterparties should be subject to the 10% limit.

We feel the primary focus of the CSA and the Proposed Amendments should be on the alternative fund's selection of its' prime broker. We propose that: (a) the CSA focus on regulating the entities that can qualify to act as a prime broker for alternative funds, for example, the prime broker must be an IIROC member that meets the criteria in sections 6.2.3 (a) and (b) of NI 81-102; (b) an alternative fund should be permitted to use a non-Canadian prime broker subject to that entity meeting the criteria in section 6.3 of NI 81-102; and (c) for larger funds, the prime broker counterparty risk could be further reduced by requiring the use of two or more prime brokers when the fund reaches a defined AUM threshold.

We also recommend the CSA consult with representatives from the Canadian prime broker industry to discuss the mechanics and structure of a prime broker account in more detail to ensure all the CSA's concerns are addressed in the prime broker account agreement that will govern the relationship between the alternative fund and the prime broker and to confirm that the Proposed Amendments will permit the inclusion of all the terms in the agreement.

2. Leverage Limit

We welcome the proposal to allow alternative funds to use leverage. There are a number of low risk alternative strategies that rely on the use of leverage to achieve attractive risk adjusted returns. However, we don't believe all alternative funds should be subject to the same leverage limit. Different alternative strategies have different risk profiles which should lead to different leverage limits. As an example, it is our opinion that the risk profile of low volatility relative value fixed income strategies can support a leverage limit of up to 5 times.

There are alternate approaches that can be used to calculate the leverage limit that the CSA should consider. The first would link the leverage limit to the risk classifications outlined in the Investment Funds Institute of Canada's ("IFIC") publication titled "Voluntary Guidelines for Fund Managers Regarding Fund Volatility Risk Classification" dated August 2014. The second would link the leverage limit to the IIROC margin guidelines that the prime brokers use to calculate their margin requirements.

We haven't included the details of our analysis on why these approaches are a more effective way of matching leverage limits to the underlying risk of the fund but we welcome the opportunity to provide those details if the CSA wants to explore them further.

3. Leverage Calculation

As noted in the Proposed Amendments there are three sources of leverage available to an alternative fund, borrowings, short sales and derivatives. It is our view that the regulations should set an overall leverage limit but not limit the amount of leverage that can be created by each of the three sources. An alternative fund that does not trade derivatives should be permitted to generate the permitted leverage using a combination of short sales and borrowings. Using the Proposed Amendments, an alternative fund that does not trade derivatives can achieve a maximum leverage of 1.5 times. And, relative value alternative funds that rely on short sales to hedge specific risks should be permitted to generate the leverage through short sales only. By restricting the use of borrowings and short sales to generate leverage the Proposed Amendments will promote increased use of derivatives to generate leverage. All sources of leverage have different risks but we feel none of the sources are riskier than the others if they are managed properly.

For many alternative strategies, short sales and derivatives are primarily used as hedges. These hedges will reduce the overall risk in the portfolio and should not restrict the fund's ability to use leverage. As such, we recommend short sales and derivatives that are designated as a hedge be excluded from the leverage calculation. The concept of exempting derivatives that are classified as a hedge from certain regulation already exists in NI 81-102.

The calculation of borrowings should be net of any cash and cash equivalents held in the same account. This may occur if an alternative fund purchases foreign currency securities and borrows that foreign currency to hedge the exchange rate risk despite the fact they are holding Canadian dollar cash.

4. Short Sale Issuer Concentration Limit

The short sale of government bonds is a widely used interest rate hedge methodology for relative value fixed income strategies. They are more efficient, more cost effective and lower risk than hedging the interest rate risk with derivatives. Therefore, we feel that section 2.6.1 of the Proposed Amendments should be amended to exclude government securities from the short sale single issuer concentration limit. This would be consistent with the exemption of government securities from the long issuer concentration limit in section 2.1 of NI 81-102.

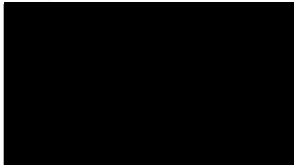
5. Subscriptions and Redemptions

While we agree that alternative funds should provide a reasonable degree of liquidity we believe the daily calculation of a net asset value and the corresponding processing of subscriptions and redemptions on a daily basis is too onerous and won't necessarily be demanded by prospective investors. We believe the operational demands on the manager and the fund's administrator and the incremental cost to the fund of providing daily liquidity isn't justified. We recommend that NI 81-106 be updated to permit alternative funds to calculate net asset value on at least a monthly basis. This will allow the alternative funds to process subscriptions and redemptions on the same frequency. We further recommend that the alternative fund's subscription and redemption terms be clearly disclosed in its prospectus.

Conclusion

We appreciate the opportunity to comment on the Proposed Amendments. We would welcome the opportunity to meet with the CSA to further discuss our recommendations and to discuss our experiences in the exempt market. We feel this is a great opportunity to update the current rules but it is important that the changes achieve the objectives and goals of the CSA.

Sincerely,



John Young
Chief Compliance Officer



Andrew Torres
Chief Investment Officer