McCarthy Tétrault LLP
Box 48, Suite 5300
Toronto Dominion Bank Tower
Toronto ON M5K 1E6
Canada
Tel: 416-362-1812
Fax: 416-868-0673

Andrew R. Armstrong
Direct Line: 416-601-8310
Email: aarmstro@mccarthy.ca

December 22, 2016

Delivered By Email: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

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 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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, QC H4Z 1G3

Dear Sirs and Mesdames:

RE: CSA Notice and Request for Comment
Modernization of Investment Fund Product Regulation – Alternative Funds

We are pleased to provide comments in response to the proposed amendments (the "**Proposed Amendments**") outlined in the CSA Notice and Request for Comment published on September 22, 2016 (the "**Notice**") concerning the final phase of the CSA's modernization of investment fund product regulation (the "**Modernization Project**") which include, among other things, a comprehensive framework for the regulation of "alternative funds" under National Instrument 81-102 - *Investment Funds* ("**NI 81-102**"). This letter is a follow up to our letter dated August 22, 2013 concerning Phase 2 of the Modernization Project (the "**Previous Comment Letter**").

Specific Comments

You have asked for specific feedback with respect to certain questions in Appendix A to the Notice and the numbers and headings below correspond to your questions in the Appendix to the extent we have feedback to provide. Defined terms used in this letter that are not otherwise defined have the meanings ascribed to them in the Notice.

1. Definition of Alternative Fund

We generally support the use of the term "alternative fund", but note that many other jurisdictions use the term "alternative fund" to connote hedge fund type structures. However, it is not apparent to us why the CSA felt the need to define an alternative fund as a type of mutual fund or to integrate alternative funds into NI 81-102. The CSA proposal for alternative funds, although more liberal in restrictions than those applied to traditional mutual funds, is still much more restricted than other funds in the global alternative fund world and as set forth below we believe a number of these restrictions should be reconsidered.

Investment Restrictions

As stated in the Previous Comment Letter, it is worth noting that investment restrictions for NRIFs are created for each specific investment strategy and asset class and this process which involves the investment fund manager, the dealers and their respective lawyers does not appear to have created any issues identified in the Notice. The investment restrictions are clearly disclosed in the prospectus of each NRIF and we would like to reiterate that we believe that disclosure is a better approach for NRIFs than a rules based approach which by its nature is less flexible and has the potential to limit investment options.

3. Concentration

We do not generally believe that an upper limit or hard cap on concentration is required for an alternative fund or a NRIF. While we agree with the CSA that a 10% or 20% concentration limit is typical in the majority of NRIFs, we do not believe that it is necessary to codify 20% as an absolute limit for NRIFs. NRIFs, like alternative funds, are not meant to provide investors with a complete investment solution and therefore creating a limit of 20% does not seem appropriate. If a hard cap is imposed for NRIFs, we would suggest a broader fixed portfolio exemption than is currently contemplated. In particular, any proposed NRIF that by its investment strategy has a "rules based" or formulaic approach to investing should be exempt from the concentration restriction including with respect to any rebalancing or portfolio substitutions.

5-7. Illiquid Assets/Redemptions

As described in the Previous Comment Letter with respect to NRIFs, as NRIFs do not have the same liquidity requirements with respect to funding ongoing redemptions as mutual funds, we think it is appropriate that they have the ability to hold larger amounts of illiquid assets. We do not agree with the proposed cap on the amount of illiquid assets held by a NRIF at 20% of NAV at the time of purchase (with a hard cap of 25% of NAV). The fact that NRIFs at most have a NAV redemption annually means that their need for liquidity is significantly less than that of a mutual fund. In addition, in circumstances where a NRIF is investing in a less liquid asset, the amount of notice required to be given in connection with the annual NAV redemption is often extended to take this fact into account. This is an example of the consultative approach between the investment dealers and investment fund manager working together on a NRIF to identify appropriate structural features based on the asset class of the NRIF.

Imposing liquidity requirements on funds that do not match a fund's terms and conditions and investor expectations may impose unwarranted costs on investors including restrictions that limit innovation and differentiation. We also do not believe that securities regulators should seek to impose portfolio restrictions for other reasons such as “safety” or capital preservation which is better left to investment dealers and investment fund managers working together to assess and manage in the context of the market.

8. Borrowing

We do not agree with the proposal limiting alternative funds and NRIFs to borrowing only from entities that meet the definition of a custodian for investment fund assets in Canada. A fund that borrows from a lender is not subject to the credit risk of that lender and therefore it is not clear what potential harm the CSA is attempting to address with this proposal. The proposal has the potential to increase the cost of borrowing for funds by providing fewer alternatives from which to borrow.

10. Total Leverage Limit

We believe that any leverage limit imposed by the CSA should take into account offsetting or hedging transactions to reduce a fund’s calculated leverage exposure. Any specified derivative that is not typically expected to create leverage should be excluded from a fund’s leverage calculation. If the CSA is intent on limiting leverage for NRIFs and alternative funds it should focus on investments that actually create leverage in order to ensure that such limits do not have the unintended consequence of limiting legitimate hedging strategies.

16. Transition

We do not believe that a transition period is appropriate and that funds that are in existence prior to the coming-into-force date of the Proposed Amendments should be grandfathered from the investment restriction changes. The rationale for this is that existing funds at that time will have been sold on a specific basis to investors and investors will expect that they have the benefit of the investment strategy that was sold to them when they acquired the applicable fund. If funds are required to transition, the impact would be to effectively substitute the CSA’s views as to appropriate portfolio management strategies for those of the portfolio managers who created the fund and we do not feel that that would be appropriate.

Other Comments

Dodd-Frank Relief

We support the codification of the exemptive relief granted to mutual funds from the counterparty designated rating requirement of s. 2.7(1) of NI 81-102, the counterparty exposure limits of s. 2.7(4) of NI 81-102 and the custodian requirements of Part 6 of NI 81-102 with respect to cleared specified derivatives. However, in our view, the wording of the proposed amendments in s. 6.8 does not accomplish this as it relates to the custodian requirements. The stated intention of the proposed amendments in s. 6.8 is to exempt the custodian requirements for “cleared specified derivatives”. The new definition of “cleared specified derivatives” captures both exchange traded and over-the-counter (OTC) derivatives, as intended. However, the current wording of this exemption only applies to clearing corporation options, options on futures or standardized futures, all of which are exchange traded transactions and therefore, simply substituting “clearing corporation options, options on futures or standardized futures” with “cleared specified derivatives” in s. 6.8 will not work.

Specifically, under s. 6.8(1), the proposed amendment allows portfolio assets to be deposited as margin for cleared specified derivatives if such margin is being deposited with a "dealer that is a member of an SRO that is a participating member of CIPF". However, the vast majority of OTC derivative transactions entered into in Canada between Canadians involve a Canadian bank, as opposed to a dealer. Therefore, in our view, s. 6.8(1), as amended, should also include a reference to a Canadian bank.

In addition, with respect to s. 6.8(2)(a), OTC derivatives entered into with foreign counterparties may not be with a "dealer" that is a member of a futures exchange or is a member of a stock exchange. However, those foreign counterparties are likely banks or dealers who are participants or members of a centralized clearing corporation. Therefore, in our view, s. 6.8(2)(a), as amended, should include a reference to a bank or dealer that is a member of a "regulated clearing agency".

Counterparty Requirements

We do not support the removal of the exemption for alternative funds and NRIFs from the exposure limits under s. 2.7(4) and s. 2.7(5) of NI 81-102, or the addition of s. 2.1(1.1) of NI 81-102 as it applies to prepaid specified derivatives. A prepaid specified derivative means that, upon entering into the transaction, the investment fund pays all of its obligations up front and therefore has no further obligations under the transaction. These types of transactions are beneficial to investment funds, allowing them to defer the recognition of amounts for tax purposes until the maturity of the prepaid specified derivative.

In fact, we would support an exemption for any investment fund from s. 2.1, s. 2.4, s. 2.7(4) and s. 2.7(5) of NI 81-102 (the "**Applicable Sections**") with respect to a prepaid specified derivative transaction, as long as (i) the investment fund's counterparty has a designated rating at all times, and (ii) the counterparty's obligations under the prepaid specified derivative transaction are fully collateralized. For this purpose, the term "fully collateralized" means that the collateral held by the investment fund plus the prepaid specified derivative is marked to market on a weekly basis and the amount of collateral will be adjusted each week to ensure that the market value of the collateral held by the investment fund will be equal to the mark-to-market value of the corresponding prepaid specified derivative. We submit that, as long as those two conditions are met, the investment fund is fully protected and should not be prevented from entering into a prepaid specified derivative which it would otherwise be pursuant to the Applicable Sections.

Definition of Illiquid Assets

Further to the Prior Comment Letter, we believe that the definition of illiquid asset in NI 81-102 as currently drafted does not reflect the current reality of the market and would suggest that prior to the CSA extending the reach of this definition to NRIFs and alternative funds that this definition be updated or, at the very least, clarified. Specifically, the reference to ". . . through market facilities on which public quotations in common use are widely available . . ." raises the question as to whether asset classes such as senior loans and/or high yield bonds would technically be deemed to be an "illiquid asset" in spite of the fact that there are deep and liquid markets for both of these asset classes. Accordingly, we believe this definition must be updated.

Status of an "alternative fund"

We think that an alternative fund should have the flexibility to be either a mutual fund or a NRIF. Practically, in order to be listed, an alternative fund could not be redeemable on demand. Such a fund would be able to adopt the redemption feature of a NRIF with an annual redemption at NAV. We also think that an unlisted alternative fund should be able to adopt a redemption frequency of its choosing such as monthly, quarterly or semi-annually.

* * * * * * * * *

Prior to implementing the Proposed Amendments, we believe it will be beneficial for the CSA to continue to consult with industry participants in a meaningful way.

Thank you for the opportunity to comment on the Proposed Amendments. We would be happy to discuss any of the above with you further. If you have any questions, please do not hesitate to contact Andrew Armstrong or Michael Eldridge.

Yours truly,

McCarthy Tétrault LLP

(Signed) "Andrew Armstrong"

Andrew R. Armstrong

AA/mt