Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment
Draft *Regulation to Amend Regulation 81-102 respecting Mutual Funds* and Draft Amendments to *Policy Statement to Regulation 81-102 respecting Mutual Funds* and Related Consequential Amendments
-and-
Other Matters Concerning *Regulation 81-104 respecting Commodity Pools* and Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

March 27, 2013

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing for a 90-day comment period draft *Regulation to Amend Regulation 81-102 respecting Mutual Funds* (Regulation 81-102) (the Draft 81-102 Amendments, as set out in Annex E) to introduce core operational requirements for publicly offered non-redeemable investment funds, other than scholarship plans.[1] As described below, some of the Draft 81-102 Amendments relate to mutual funds. We are also publishing for comment draft amendments to *Policy Statement to Regulation 81-102 respecting Mutual Funds* (Policy Statement 81-102) (the Draft Policy Statement 81-102 Amendments).

Related consequential amendments are also being published for comment with this Notice:

- to reflect the proposed change in the name of Regulation 81-102; and
- to update *Regulation 41-101 respecting General Prospectus Requirements* (Regulation 41-101), including Form 41-101F2 *Information Required in an Investment Fund Prospectus* (Form 41-101F2).

The proposed rule amendments described above are collectively referred to in this Notice as the Draft Amendments. The Draft Amendments, together with the Draft Policy Statement 81-102 Amendments, are referred to as the "Proposed Provisions". The Proposed Provisions, together with the proposals relating to *Regulation 81-104 respecting Commodity Pools* (Regulation

[1] Scholarship plans are being considered by the CSA in a separate initiative. References to "non-redeemable investment funds" in this Notice do not include scholarship plans. In British Columbia, labour sponsored venture capital corporations registered under the *Employee Investment Act* (British Columbia) and venture capital corporations registered under the *Small Business Venture Capital Act* (British Columbia) would need to comply with Regulation 81-102 if the Draft 81-102 Amendments are adopted. An Annex, published in British Columbia, describes how the changes would impact these funds.

81-104) and securities lending, repurchases and reverse repurchases described below, represent the first stage in Phase 2 of the CSA's implementation of the Modernization of Investment Fund Product Regulation Project (the Modernization Project).

In addition to the Draft 81-102 Amendments, the Modernization Project also involves the creation of a more comprehensive alternative fund framework, to be effected through amendments to Regulation 81-104, that would operate in conjunction with the Draft 81-102 Amendments. The framework would govern investment funds that invest in assets, or use investment strategies, that would not be permitted by the Draft 81-102 Amendments. The framework is intended to create a more consistent, fair and functional regulatory regime across the spectrum of publicly offered investment fund products. We are seeking feedback on the appropriate parameters for the alternative fund framework.

The Modernization Project also includes the enhancement of the disclosure requirements relating to securities lending, repurchases and reverse repurchases by investment funds. We are also seeking feedback on how disclosure pertaining to these activities should be enhanced.

Background

The mandate of the Modernization Project is to review the product regulation of publicly offered investment funds and to consider whether our current regulatory approach sufficiently addresses product and market developments in the Canadian investment fund industry, and continues to adequately protect investors. The types of investment funds covered by the Modernization Project are publicly offered mutual funds (including exchange-traded mutual funds) and non-redeemable investment funds. The Project is being carried out in phases.

(i) Phase 1

In Phase 1, the CSA focused primarily on publicly offered mutual funds in amending Regulation 81-102, *Regulation 81-106 respecting Investment Fund Continuous Disclosure* (Regulation 81-106) and other investment fund rules to codify exemptive relief that had been frequently granted in recognition of market and product developments. As well, we made amendments to keep pace with developing global standards in mutual fund product regulation, notably, introducing maturity restrictions and liquidity requirements for money market mutual funds. The Phase 1 amendments came into force on April 30, 2012, except for the provisions relating to money market funds, which came into force on October 30, 2012.

(ii) Phase 2

The CSA's objective in Phase 2 is to identify and address any market efficiency, investor protection or fairness issues that arise out of the differing regulatory regimes that apply to different types of publicly offered investment funds. In May 2011, we published CSA Staff Notice 81-322 *Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project and Request for Comment on Phase 2 Proposals* (Staff Notice 81-322) to set out a two-staged approach to Phase 2 and to seek comment on our proposed approach.

First Stage of Phase 2

In the first stage of Phase 2, now underway, we are focusing on implementing an operational rule for non-redeemable investment funds. Historically, operational requirements have not been applied to non-redeemable investment funds although, like mutual funds, they are subject to the continuous disclosure and fund governance requirements set out in Regulation 81-106 and *Regulation 81-107 respecting Independent Review Committee for Investment Funds* (Regulation 81-107), respectively.

While non-redeemable investment funds are not new to the investment fund product landscape, their structure and characteristics have evolved along with the investment fund industry. Non-redeemable investment funds now use diverse investment strategies and provide investors with exposure to a variety of assets. In a time of increasing product innovation, we indicated in Staff Notice 81-322 that a staged approach will allow us to focus first on strengthening investor protection and addressing fairness issues arising out of the lack of an operational rule for non-redeemable investment funds. As well, introducing an operational rule for non-redeemable investment funds will level the playing field among non-redeemable investment funds, conventional mutual funds and exchange-traded mutual funds, providing a more consistent framework within which these funds can compete with each other.

In Staff Notice 81-322, we indicated that we were considering the adoption of core restrictions and other operational requirements, analogous to those in Regulation 81-102, for non-redeemable investment funds. These requirements could include, for example, certain conflicts of interest provisions and securityholder and regulatory approvals for fundamental changes to a non-redeemable investment fund and its management. In addition, we sought feedback on whether there were other restrictions and operational requirements that would be appropriate for non-redeemable investment funds and whether investment restrictions similar to those in Part 2 of Regulation 81-102 should apply to non-redeemable investment funds. We also sought feedback on a stand-alone operational rule for non-redeemable investment funds and the advantages and disadvantages of this approach.

Key Feedback Received on Staff Notice 81-322

In the feedback we received on Staff Notice 81-322, many commenters expressed the view that investment restrictions similar to those contained in Part 2 of Regulation 81-102 should not be adopted for non-redeemable investment funds because the primary distinction between mutual funds and non-redeemable investment funds is the flexibility to use alternative investment strategies to provide investors with exposure to different asset classes and innovative techniques. We were told this distinction is beneficial to investors and should not be eliminated. We have observed, however, that non-redeemable investment funds use a range of investment strategies that involve different levels and types of risks. Many non-redeemable investment funds invest using more conventional investment strategies similar to those used by mutual funds governed by Regulation 81-102. Others invest beyond the limits set out in Regulation 81-102.

While the CSA recognize that non-redeemable investment funds differ from mutual funds in certain key aspects, we do not agree that the differences provide a sufficient policy basis to support the absence of any investment restrictions for publicly offered non-redeemable

investment funds. Accordingly, we are proposing to include non-redeemable investment funds in the restrictions and practices in Regulation 81-102 that, in our view, represent fundamental requirements for all publicly offered investment funds.

We think that many of the investment restrictions in Part 2 of Regulation 81-102 represent fundamental requirements, as the restrictions:

- establish parameters for investment funds to meet the expectations of retail investors who invest in pooled investment products;[2]

- prohibit activities that are inconsistent with the fundamental characteristics of investment funds as passive investment vehicles;[3] or

- reflect prudent fund management practices.[4]

We recognize, however, that certain investment restrictions in Part 2 of Regulation 81-102 may need to be modified for non-redeemable investment funds because of the differences discussed below.

Taking into account the feedback on Staff Notice 81-322, we accept that investors may benefit from a wider array of investment choices. The CSA wish to preserve the flexibility for non-redeemable investment funds to provide investors with access to alternative investment strategies. Accordingly, concurrently with the Draft 81-102 Amendments, we are considering how to redesign Regulation 81-104 to expand the regulation to include both mutual funds and non-redeemable investment funds that wish to use alternative investment strategies that would go beyond the parameters of Regulation 81-102 (these investment funds are referred to as "alternative funds"). See "Modernization Project – Alternative Funds Framework" below.

We anticipate finalizing certain aspects of the Draft 81-102 Amendments in advance of others. These include the proposed conflicts of interest provisions, securityholder and regulatory approval requirements, and custodianship requirements. Other aspects, particularly certain proposed investment restrictions that are interrelated with Regulation 81-104, will require more time to consider and evaluate. We expect these components to be considered in conjunction with any related amendments to Regulation 81-104 and to come into force contemporaneously at a later date.

More detailed responses to the comments on Staff Notice 81-322 are in Annex D of this Notice.

[2] For example, diversification requirements for retail investors to benefit from greater diversification through investing in a fund as compared to investing on an individual account basis.

[3] For example, prohibitions on investing in real property or in issuers for the purpose of controlling them.

[4] For example, restrictions relating to securities lending, repurchases and reverse repurchases.

Second Stage of Phase 2
In the final stage of this initiative, the CSA will review the investment restrictions applicable to mutual funds in Part 2 of Regulation 81-102 to assess if any changes should be made in light of market and product developments.

Substance and Purpose of the Proposed Provisions

The Draft 81-102 Amendments introduce core operational requirements for non-redeemable investment funds, analogous to those applicable to mutual funds in Regulation 81-102. They will provide baseline protections for investors, regardless of whether they purchase an investment fund product structured as a mutual fund or a non-redeemable investment fund. They will also mitigate the potential for regulatory arbitrage within the current investment fund regulatory regime by levelling the playing field among non-redeemable investment funds, conventional mutual funds and exchange-traded mutual funds and providing a more consistent regulatory framework for comparable investment products.

The Draft 81-102 Amendments, together with amendments to Regulation 81-104 required in the design of an alternative funds framework, are expected to provide sufficient flexibility for mutual funds and non-redeemable investment funds to give investors access to alternative investment strategies, and to help investors differentiate amongst the various types of publicly offered investment fund products. These amendments are expected to contribute to more efficient capital markets by providing greater certainty and consistency for investment funds and their managers regarding the regulatory framework that they must follow.

The CSA, in the context of the Modernization Project, also seek to keep pace with developing global standards by enhancing the disclosure requirements relating to securities lending, repurchase and reverse repurchase transactions by investment funds.[5]

The other components of the Draft Amendments, as well as the Draft Policy Statement 81-102 Amendments, are consequential to the Draft 81-102 Amendments.

Summary of Draft Amendments

The proposed operational requirements for non-redeemable investment funds in the Draft 81-102 Amendments parallel many requirements applicable to mutual funds in Regulation 81-102. The CSA are of the view that many of the requirements in Regulation 81-102 provide core protections for investors that invest in investment funds and should not be limited only to mutual fund investors. Accordingly, we propose that similar provisions apply to non-redeemable

[5] See, for example: Financial Stability Board, Strengthening Oversight and Regulation of Shadow Banking – A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (18 November 2012) online: <http://www.financialstabilityboard.org/publications/r_121118b.pdf>; European Securities and Markets Authority, Guidelines on ETFs and other UCITS issues – Consultation on Recallability of Repo and Reverse Repo Arrangements (25 July 2012) online: <http://www.esma.europa.eu/system/files/2012-474.pdf>; International Organization of Securities Commissions, Principles for the Regulation of Exchange Traded Funds (March 2012) online: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD376.pdf>.

investment funds. In some instances, we have proposed alternative requirements that recognize the differences between non-redeemable investment funds and mutual funds.

(i) Similarities and Differences between Mutual Funds and Non-Redeemable Investment Funds

Non-redeemable investment funds are similar to mutual funds in many ways. Under securities legislation, the primary purpose of both types of investment funds is to invest money provided by their securityholders. Both types of investment funds offer the benefits of pooled investment and portfolio management services to the public.

However, the CSA recognize that non-redeemable investment funds differ from mutual funds and, in particular, conventional mutual funds, in certain key aspects. Unlike conventional mutual funds, non-redeemable investment funds do not offer unlimited securities on a continuous basis and they do not redeem their securities at net asset value (NAV) on a regular basis. Instead, non-redeemable investment funds typically issue a fixed number of securities in an initial public offering,[6] following which the securities are generally listed and trade on an exchange at market prices which may be at a premium or discount to NAV. Many non-redeemable investment funds also give investors the right to redeem their securities annually at a price based on the NAV of the securities,[7] while others have a fixed life. Finally, while conventional mutual funds are primarily distributed by mutual fund dealers, non-redeemable investment funds are generally only distributed by investment dealers in the underwriting syndicate for the funds' public offering.

The key elements of the Draft Amendments are outlined below. A consolidated list of the specific issues in the Draft 81-102 Amendments on which we seek comment is set out in Annex A.

(ii) Investment Restrictions

As noted above, we think that many of the investment restrictions in Part 2 of Regulation 81-102 represent fundamental requirements that should apply to non-redeemable investment funds. In our review of the investment restrictions adopted by existing non-redeemable investment funds, we have observed that many non-redeemable investment funds have adopted several of the restrictions in Part 2 in their constating documents. We think that certain of the investment restrictions in Part 2 of Regulation 81-102 that impose constraints designed to limit risks for retail investors also represent prevailing industry best practices for investment funds that invest using conventional investment strategies.[8] Accordingly, we propose that those restrictions in Part 2 also apply to non-redeemable investment funds that invest using conventional investment strategies. Extending Part 2 to include these non-redeemable investment funds will result in the

[6] Non-redeemable investment funds are commonly referred to as "closed-end funds" because they issue a fixed number of securities rather than an unlimited number of securities on a continuous basis.

[7] The CSA generally take the view that where an investment fund redeems its securities based on NAV less frequently than once a year, the fund does not provide an "on demand" redemption feature and is therefore not a mutual fund subject to the requirements of Regulation 81-102. Please also see "Redemptions" below.

[8] For example, limits on short selling and cover requirements for derivative positions.

same regulatory protections for investors of all investment funds using conventional strategies, regardless of whether the fund is structured as a mutual fund or a non-redeemable investment fund.

We propose not to apply certain provisions in Part 2 of Regulation 81-102 to non-redeemable investment funds where differences between mutual funds and non-redeemable investment funds provide a basis for different requirements. Instead, we propose alternative provisions that recognize the differences and we propose limits that act as prudent safeguards.

Concentration Restriction

Many existing non-redeemable investment funds have adopted a concentration restriction that requires them to limit their investment in an issuer to an amount equal to 10% of NAV at the time of purchase, similar to the concentration restriction in section 2.1 of Regulation 81-102. Based on this prevailing practice, it appears that a 10% concentration limit is considered an industry best practice in providing a minimum level of diversification.

Therefore, we are proposing that a concentration restriction be adopted for non-redeemable investment funds, based on section 2.1 of Regulation 81-102. We also propose that the definition of "fixed portfolio ETF" in Regulation 81-102 be amended to permit a non-redeemable investment fund that has a fundamental investment objective of holding and maintaining a fixed portfolio of publicly traded equity securities of issuers named in their prospectus to exceed the 10% concentration restriction in section 2.1 of Regulation 81-102. We seek comment on whether a 10% concentration restriction is appropriate for non-redeemable investment funds and, if not, why a higher issuer concentration restriction would be appropriate for non-redeemable investment funds. We are also considering whether "alternative funds" governed by Regulation 81-104 should be permitted to have a more generous concentration restriction than in section 2.1 of Regulation 81-102. See "Modernization Project – Alternative Funds Framework" below.

Investments in Physical Commodities

We are proposing to limit investments by a non-redeemable investment fund in physical commodities and specified derivatives the underlying interests of which are physical commodities to, in the aggregate, an amount equal to 10% of NAV at the time of purchase. This limit is similar to the limit imposed in recent orders that granted exemptive relief to mutual funds to permit them to make these types of investments. Non-redeemable investment funds that wish to focus on physical commodities or derivatives that provide exposure to physical commodities may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

Investments in Illiquid Assets

We are proposing that non-redeemable investment funds be permitted to invest a larger portion of their assets in illiquid assets than mutual funds. We note that, unlike mutual funds, non-redeemable investment funds generally do not offer regular redemptions based on NAV. Rather, most of them primarily offer liquidity through listing their securities on an exchange. We seek comment on the limit on illiquid asset investments that would be appropriate for non-redeemable investment funds.

Borrowing

We are proposing that non-redeemable investment funds be permitted to borrow cash up to an amount equal to 30% of NAV. The 30% borrowing limit generally reflects the current practice of the majority of existing non-redeemable investment funds, which limit their cash borrowings to an amount that is between 10% to 33% of NAV.

We also think that requiring borrowing from a lender that is licensed to carry on a lending business could provide additional monitoring and controls over a non-redeemable investment fund's cash borrowings that are based on the investment strategies and financial condition of the specific fund. We are proposing that non-redeemable investment funds borrow from a "Canadian financial institution" (as defined in *Regulation 14-101 respecting Definitions*), as we have observed that existing non-redeemable investment funds generally borrow from Schedule I or II banks. We seek comment on whether this requirement for non-redeemable investment fund borrowings is appropriate. We are also considering whether non-redeemable investment funds that are "alternative funds" regulated under Regulation 81-104 should be permitted to borrow more than 30% of NAV. See "Modernization Project – Alternative Funds Framework" below.

We also note that under the Draft 81-102 Amendments, non-redeemable investment funds would be able to create leverage only through cash borrowings. Non-redeemable investment funds that wish to create leverage through the use of specified derivatives (as defined in Regulation 81-102) or short selling may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

Investments in Mortgages

We are proposing that there be no limit on a publicly offered non-redeemable investment fund's investments in guaranteed mortgages (as defined in Regulation 81-102). We are also proposing that mortgage investments by these types of funds be restricted to guaranteed mortgages. The CSA are of the view that mortgages that are not fully and unconditionally guaranteed by a government or government agency ("non-guaranteed mortgages") may not be appropriate investments for publicly offered investment funds.[9]

We have observed that there is currently a limited number of existing publicly offered non-redeemable investment funds that have investment objectives of investing in non-guaranteed mortgages. We therefore are proposing a 24 month transition period for the application of the restriction in proposed paragraph 2.3(2)(b), to give these types of funds time either to divest their holdings of non-guaranteed mortgages (which would trigger a change in investment objective if the fund's investment objectives state that the fund will be investing in non-guaranteed mortgages) or to transition into the regulatory regime for issuers that are not investment funds. We are seeking comment on the impact of the proposed restriction on non-guaranteed mortgage investments and the appropriate length of the transition period. We are also seeking comment on alternatives to a transition period, such as a grandfathering provision, and the impact of this alternative.

[9] For a discussion about the investments of mortgage investment entities, see CSA Staff Notice 31-323 *Guidance Related to the Registration Obligations of Mortgage Investment Entities*.

Fund-of-Fund Structures
We are proposing that non-redeemable investment funds be required to follow the requirements in subsection 2.5(2) of Regulation 81-102 when investing in mutual funds. We also propose that non-redeemable investment funds not be permitted to invest in other non-redeemable investment funds. Otherwise, a non-redeemable investment fund could have portfolio exposure that is greater than 130% of its NAV if it invests in an underlying non-redeemable investment fund that leverages its portfolio through cash borrowings. The CSA have also observed that non-redeemable investment funds generally do not seek to invest in other non-redeemable investment funds. Non-redeemable investment funds that wish to use greater leverage may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

We also seek feedback on the application of proposed paragraphs 2.5(2)(a) and (c) of Regulation 81-102 to certain non-redeemable investment funds that use a fund-of-fund structure involving an underlying mutual fund.

Securities Lending, Repurchases and Reverse Repurchases
We think that non-redeemable investment funds should engage in securities lending, repurchases and reverse repurchases on the same basis as mutual funds. Therefore, we are generally proposing that the framework applicable to securities lending, repurchases and reverse repurchases by mutual funds apply to non-redeemable investment funds. We also propose to amend paragraphs 2.12(1)12 and 2.13(1)11 of Regulation 81-102 such that the aggregate market value of securities loaned under securities lending transactions or sold in repurchase transactions by an investment fund may not exceed an amount equal to 50% of the fund's NAV.

Paragraphs 2.12(1)12 and 2.13(1)11 currently state that the aggregate market value of the securities loaned under securities lending transactions or sold in repurchase transactions may not exceed 50% of the fund's total assets, not including the collateral held by the fund for the loaned securities and the cash held by the fund for the sold securities. The draft amendments to paragraph 2.12(1)12 and 2.13(1)11 would mean that non-redeemable investment funds, which are proposed to be permitted to borrow cash up to an amount equal to 30% of their NAV, may not include any borrowed cash (or portfolio assets purchased with borrowed cash) in calculating the maximum market value of their securities that may be loaned under securities lending transactions or sold in repurchase transactions. For mutual funds, the CSA consider that the impact of this proposed amendment would be minimal as mutual funds are generally not permitted to be leveraged and their liabilities are generally not significant relative to their total assets.

(iii) New Non-Redeemable Investment Funds

Seed Capital
As noted above, non-redeemable investment funds typically raise sufficient funds for investment purposes by issuing a fixed number of securities in their initial public offering, instead of engaging in a continuous distribution of securities. Because of the differences in capital raising models of mutual funds and non-redeemable investment funds, the CSA do not think that the

seed capital and minimum subscription requirements in sections 3.1 and 3.2 of Regulation 81-102 should apply to non-redeemable investment funds.

Organizational Costs

Proposed subsection 3.3(3) of Regulation 81-102 prohibits the costs of organizing a new non-redeemable investment fund from being borne by the fund. Currently, managers that launch non-redeemable investment funds do not pay any of the organizational costs; instead, the costs are paid out of the proceeds of the initial public offering of the non-redeemable investment fund. On the other hand, managers that launch mutual funds must pay the costs of establishing new mutual funds and then recoup the costs through the ongoing management fee charged to the fund. The CSA recognize that non-redeemable investment funds undertake an initial public offering that raises a fixed amount of money in a limited amount of time, rather than offering securities on a continuous basis. While this has historically accounted for the difference in organizational cost payment models between non-redeemable investment funds and mutual funds, the CSA think it is important to examine the application of proposed subsection 3.3(3) of Regulation 81-102 to non-redeemable investment funds.

Both investors and managers benefit from managers establishing investment funds that are sustainable in the long term. However, the financial risk of launching a non-redeemable investment fund that may not be sustainable appears to be borne only by investors if all of the organizational costs are paid out of the proceeds of the initial public offering. Therefore, requiring managers to pay the organizational costs of a new non-redeemable investment fund could be perceived to further align the interests of managers with those of investors.

Another potential benefit of the proposed provision is that it may increase the efficiency of non-redeemable investment fund launches. The proposed provision could further strengthen the manager's interest in minimizing organizational costs to reduce its initial outlay, resulting in cost efficiencies when launching new funds. Also, as certain organizational costs are fixed, it appears to the CSA that launching a larger fund may be more cost efficient than launching multiple smaller funds, which may have the potential disadvantages of higher per unit operational costs and lower secondary market liquidity.

Finally, the introduction of a requirement for the manager to pay the organizational costs of launching a new non-redeemable investment fund will level the playing field between mutual fund managers and non-redeemable investment fund managers and may discourage arbitrage opportunities. The CSA have observed several instances where managers launch mutual funds without paying any organizational costs by creating a non-redeemable investment fund and then converting it into a mutual fund after a short period of time.

We recognize that if managers are required to pay organizational costs, managers that cannot finance the organizational costs would not be able to launch new non-redeemable investment funds. As well, smaller non-redeemable investment funds may not be launched. We seek comment on the potential impact and the benefits and costs of proposed subsection 3.3(3) for non-redeemable investment funds. In addition, we seek comment on whether the different capital raising model followed by non-redeemable investment funds may support the fund continuing to pay some of the organizational costs out of the proceeds of the initial public offering of the fund

and whether there are specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the manager.

(iv) Conflicts of Interest

We are proposing to apply the conflicts of interest provisions in Part 4 of Regulation 81-102 to non-redeemable investment funds. The introduction of these provisions will extend key protections to non-redeemable investment fund investors. This proposal received broad support from commenters that provided feedback to Staff Notice 81-322.

(v) Fundamental Changes

We think that non-redeemable investment fund investors should have similar protections and rights as mutual fund investors relating to fundamental changes to their funds. Therefore, we are proposing to apply the provisions in Part 5 of Regulation 81-102 to non-redeemable investment funds.

Securityholder and Regulatory Approval Requirements

The CSA have observed that the constating documents of many non-redeemable investment funds incorporate investor voting rights that are similar to those in Part 5 of Regulation 81-102. However, these rights are not consistently provided by each non-redeemable investment fund offered to the public. Codifying these requirements will give all investors consistent and guaranteed voting rights on important changes that impact the fund or its management.

We propose to re-draft the requirement to obtain regulatory approval for a change in control of the manager for greater clarity and move it from subsection 5.5(2) to proposed paragraph 5.5(1)(a.1) of Regulation 81-102. While this will be a new requirement for non-redeemable investment funds, there are no substantive changes for mutual funds from the re-draft.

Proposed New Securityholder Approval Requirements

In addition to the existing requirements in Part 5, the CSA also propose that prior securityholder approval be obtained to implement a change to the nature of an investment fund. Specifically, prior securityholder approval is proposed to be required to implement any change that would convert a mutual fund into a non-redeemable investment fund, convert a non-redeemable investment fund into a mutual fund, or convert an investment fund into an issuer that is not an investment fund. In addition, the costs and expenses to implement the change (which include the costs of obtaining securityholder approval and, if applicable, the costs of filing a simplified prospectus to commence a continuous distribution) may not be borne by the investment fund.

We are proposing a limited exemption from the proposed securityholder approval requirement for a non-redeemable investment fund that is structured from inception to convert to a mutual fund upon the occurrence of a specified event. Conditions for this proposed exemption include

prospectus and sales communication disclosure of the conversion and securityholder notice prior to the conversion.

The CSA also propose an exemption to the securityholder and regulatory approval requirements for fund mergers involving specialized non-redeemable investment funds that have a limited life and that do not list or trade their securities on a secondary market. These non-redeemable investment funds are typically organized as limited partnerships and have the investment objective of providing returns through tax-assisted investments in "flow-through" shares issued by resource companies. Investors must remain invested in the funds to realize the tax benefits of their investment, with liquidity provided at the termination of the fund through a distribution of the net proceeds or a reorganization with a mutual fund under which assets are transferred on a tax-deferred basis to the mutual fund in exchange for securities issued by the mutual fund. Given the unique structure and purpose of these non-redeemable investment funds, the CSA propose that these funds be exempted from securityholder and regulatory approval requirements if they are effecting a rollover into a mutual fund, provided that certain requirements, including prospectus disclosure requirements, are met.

Proposed New Conditions for Pre-Approved Fund Mergers

In addition to the current conditions in subsection 5.6(1) of Regulation 81-102, the CSA propose that, as a condition to effect a merger of a non-redeemable investment fund with another investment fund without securityholder or regulatory approval, the non-redeemable investment fund offer to redeem its securities at their NAV at a date that is before the effective date of the merger. In our view, the ability to exit the fund at NAV helps to mitigate the need for securityholder approval.

The CSA also propose that a merger be effected at NAV as a condition for the merger to proceed without securityholder or regulatory approval. This condition helps to mitigate conflicts of interest where funds under common management are merged. The TSX Company Manual contains a similar condition for fund mergers to be implemented without securityholder approval.

Termination of Non-Redeemable Investment Funds

Proposed section 5.8.1 of Regulation 81-102 requires that non-redeemable investment funds terminate no earlier than 15 days and no later than 30 days after filing a press release to disclose the intended termination. This provision is intended to give investors sufficient time to consider the consequences of the termination and also require that money be repaid promptly to investors if a fund is terminating, as any secondary market liquidity can be expected to decline significantly after the termination of the fund is disclosed.

(vi) Custodianship Requirements

Custodianship requirements for non-redeemable investment funds that parallel the requirements for mutual funds in Part 6 of Regulation 81-102 currently exist in Part 14 of Regulation 41-101. We propose to update the drafting in Part 6 of Regulation 81-102 based on the drafting in

Regulation 41-101, and apply the updated Regulation 81-102 requirements to non-redeemable investment funds. There are no substantive changes to the custodian requirements for any investment funds, other than requiring all non-redeemable investment funds, rather than only those that file a prospectus under Regulation 41-101, to comply with the custodianship requirements. Part 14 of Regulation 41-101 will remain in order to maintain the custodianship requirements for scholarship plans.

(vii) Incentive Fees

We propose that restrictions on non-redeemable investment funds paying incentive fees apply in a similar manner as for mutual funds. Part 7 of Regulation 81-102 sets parameters for incentive fees to be charged appropriately with reference to a relevant benchmark, which we think should apply to all investment funds that use similar investment strategies. A non-redeemable investment fund that invests using alternative investment strategies permitted under Regulation 81-104 may choose to be an "alternative fund" regulated under Regulation 81-104 and pay incentive fees in accordance with that regulation. See "Modernization Project – Alternative Funds Framework" below.

(viii) Sales of Securities

The CSA do not propose to apply the provisions in Part 9 of Regulation 81-102 to non-redeemable investment funds because of the differences in the distribution models between non-redeemable investment funds and mutual funds. However, we are proposing to introduce subsections 9.3(2) and (3) to require that issuances of non-redeemable investment fund securities not cause dilution to existing securityholders. These subsections parallel the requirement that mutual fund securities be issued at NAV. We seek comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.

(ix) Warrant Offerings

Proposed new Part 9.1 of Regulation 81-102 prohibits an investment fund from issuing warrants, rights or other specified derivatives the underlying interest of which is a security of the investment fund. In recent years, the CSA have observed non-redeemable investment funds issuing warrants that could potentially dilute the value of the securities held by investors who do not exercise the warrants. Steps to mitigate dilution, such as selling the warrants on the secondary market, may be ineffective or not sufficient to compensate investors who do not exercise their warrants for the loss of the value of their securities. As warrants are automatically issued to securityholders, warrants may also appear to be coercive, with securityholders obligated to make an additional investment or face the risk of dilution.

We think that investors in a non-redeemable investment fund may not expect the costs of warrant issuances to be part of their investment bargain; specifically, investors do not generally expect that the fund they invest in will seek additional capital from them after they have made the initial investment, or that they will have to incur costs for the fund to raise additional capital. The CSA are of the view that a restriction on warrant issuances will not unduly limit the ability of an

investment fund to raise additional money. A manager that wishes to raise additional money for its fund may file a prospectus to issue new securities, provided that the issuance is not dilutive to existing securityholders.

(x) Redemptions

The CSA do not propose to apply many of the provisions in Part 10 of Regulation 81-102 to non-redeemable investment funds because of the differences in redemption models between these funds and mutual funds. However, we propose similar requirements for non-redeemable investment funds that offer annual redemptions based on NAV or more regular redemptions at market value. We are proposing that:

- like mutual funds, non-redeemable investment funds that offer redemptions send investors an annual reminder of the procedures for exercising redemptions;

- non-redeemable investment funds pay redemption proceeds promptly; specifically, no more than 15 business days after the redemption is effected;

- non-redeemable investment funds not redeem securities at an amount that is greater than the NAV of the security on the redemption date, to avoid dilution to remaining securityholders; and

- non-redeemable investment funds that offer redemptions be permitted to suspend redemptions if the requirements in section 10.6 of Regulation 81-102 are met.

Many existing non-redeemable investment funds offer redemptions of their securities based on NAV once a year. The CSA have taken the view that investment funds that offer redemptions based on NAV no more than once a year are non-redeemable investment funds. We seek comment on whether to reconsider this position.

(xi) Commingling of Cash

The CSA are proposing to amend Part 11 of Regulation 81-102 so that the provisions relating to the holding of monies from sales and redemptions in a trust account will apply to non-redeemable investment funds. The Draft 81-102 Amendments would also permit cash received in respect of sales and redemptions of all investment fund securities to be held in one account.

(xii) Sales Communications

We are proposing to apply the provisions in Part 15 of Regulation 81-102 to sales communications of non-redeemable investment funds, with modifications that recognize differences between mutual funds and non-redeemable investment funds. The proposed requirements in Part 15 do not impact the restrictions applicable during the waiting period and the period between the issuance of the receipt for the final prospectus and the closing of the prospectus offering.

We are proposing to amend section 15.6 of Regulation 81-102 such that a mutual fund that was converted from a non-redeemable investment fund must, if it wishes to present performance data, present past performance data for the period when it existed as a non-redeemable investment fund. This is consistent with the continuous disclosure requirements in Regulation 81-106, as well as exemptive relief that has been granted to such funds.

(xiii) Naming Convention for Investment Funds

We are considering whether "alternative funds" regulated under Regulation 81-104 should be required to include the words "Alternative Fund" in their name to clearly differentiate "alternative funds" from investment funds subject only to Regulation 81-102. See "Modernization Project – Alternative Funds Framework" below. We seek comment on whether investment funds that are subject only to Regulation 81-102 should also be required to include specific identifiers in their name that would identify them as investment funds that use the conventional investment strategies permitted in Regulation 81-102.

(xiv) Other Provisions relating to Non-Redeemable Investment Funds

We are proposing that non-redeemable investment funds set record dates in accordance with Part 14 of Regulation 81-102, except that if a non-redeemable investment fund lists its securities on an exchange, it may follow the rules of the applicable exchange regarding record dates.

We also propose that non-redeemable investment funds maintain and make available securityholder records in accordance with Part 18 of Regulation 81-102.

(xv) Transition Period for Certain Proposed Provisions relating to Non-Redeemable Investment Funds

As noted above, we anticipate that some aspects of the Draft 81-102 Amendments, specifically, the proposed core operational requirements for non-redeemable investment funds other than certain provisions in Part 2 of Regulation 81-102, will come into force in advance of other aspects. We expect that the introduction of certain investment restrictions in Part 2 of Regulation 81-102 and their interrelation with Regulation 81-104 will take more time to consider and evaluate. Given their interconnectedness, we expect that these components will be considered together and come into effect contemporaneously at a later date.

Currently, the CSA propose an 18 month transition period for existing non-redeemable investment funds to comply with the investment restrictions in proposed amended sections 2.2, 2.3,[10] 2.4 and 2.5 of Regulation 81-102 to give existing funds sufficient time to align their portfolios with the new requirements. Any new non-redeemable investment funds established after the coming-into-force date of the Draft 81-102 Amendments pertaining to these sections would be required to comply with the investment restrictions in Part 2 of the amended Regulation 81-102 immediately. We seek comment on the transition period and alternatives to a transition period.

[10] Other than proposed paragraph 2.3(2)(b), for which a 24 month transition period is proposed.

We are also proposing an 18 month transition period for compliance with Part 7 of Regulation 81-102, and a 6 month transition period for existing non-redeemable investment funds to continue to use sales communications (other than advertisements) that were prepared prior to the coming-into-force date of the Draft 81-102 Amendments pertaining to Part 15 of Regulation 81-102.

(xvi) Related Consequential Amendments

Amendments to Regulation 41-101, including and Form 41-101F2
Where a non-redeemable investment fund is structured to convert into a mutual fund upon the occurrence of a specified event, we propose to amend Form 41-101F2 to require specific prospectus disclosure of the conversion.

We also propose to require specific prospectus disclosure of investments in physical commodities. If an investment fund invests in physical commodities, proposed Item 6.1(7) of Form 41-101F2 will require certain disclosure under the "Investment Strategies" heading, including the types of commodities the fund may purchase, whether the commodity exposure is in the form of investments in physical commodities or investments through specified derivatives the underlying interest of which are physical commodities, and how the fund will use its investment in physical commodities to achieve its investment objectives.

Many non-redeemable investment funds redeem their securities by reference to NAV annually, with the redemption proceeds being equal to the NAV per security less certain costs that may be deducted from the NAV per security. In response to the feedback received on Staff Notice 81-322, we propose to amend Item 15 of Form 41-101F2 to require disclosure of any costs or other fees that may be deducted from the NAV per security to clarify what amount will be received upon redemption.

We propose to repeal Item 21.2 of Form 41-101F2 to reflect the proposed restrictions on borrowing by non-redeemable investment funds. As proposed subparagraph 2.6(a)(i.1) of Regulation 81-102 would restrict cash borrowings to loans from a Canadian financial institution (as defined in Regulation 14-101 respecting *Definitions*), non-redeemable investment funds would not be permitted to issue debt securities to the public.

We also propose to repeal Items 21.3 and 27 of Form 41-101F2 to reflect the proposed prohibition on investment funds offering warrants or specified derivatives the underlying interest of which are securities of the investment fund.

Finally, we propose to delete references to "subsidiaries" of investment funds in Form 41-101F2 as these references would not be consistent with proposed amended section 2.2 of Regulation 81-102.

Other Consequential Amendments
We propose minor consequential amendments to Regulation 81-106, Regulation 81-107 and its commentary, and the regulations and policy statements published with this Notice to reflect proposed changes in certain definitions in Regulation 81-102 to encompass non-redeemable

investment funds and to reflect the change in the name of Regulation 81-102 from "*Regulation 81-102 respecting Mutual Funds*" to "*Regulation 81-102 respecting Investment Funds*".

(xvii) Draft 81-102 Amendments that Impact Mutual Funds

While Phase 2 focuses on introducing operational requirements for non-redeemable investment funds, there are provisions in the Draft 81-102 Amendments that would impact mutual funds, in addition to our consideration of additional requirements relating to securities lending, repurchases and reverse repurchases by investment funds in Annex C and our proposals to redesign Regulation 81-104 described below. These provisions are:

- proposed amended sections 2.11 and 2.17 will require an exchange-traded mutual fund that is not in continuous distribution to issue a news release if the fund intends to begin using specified derivatives, short selling and entering into securities lending, repurchases and reverse repurchases transactions;

- proposed amended paragraphs 2.12(1)12 and 2.13(1)11 will limit the amount of securities loaned or sold in repurchase transactions by a mutual fund to 50% of NAV, rather than 50% of total assets, excluding the collateral delivered to the fund (see "(ii) Investment Restrictions – Securities Lending, Repurchases and Reverse Repurchases" above);

- subsection 3.3(2) is proposed to be repealed, as the rationale for introducing proposed subsection 3.3(3) for non-redeemable investment funds also applies to exchange-traded mutual funds that are not in continuous distribution (see "(iii) New Non-Redeemable Investment Funds – Organizational Costs" above);

- proposed amended paragraph 5.1(1)(g) will broaden the securityholder approval requirements to require securityholder approval for a merger of a mutual fund with any issuer, rather than a merger with another mutual fund;

- proposed new paragraph 5.1(1)(h) will require that a mutual fund that wishes to implement a change that restructures the fund into a non-redeemable investment fund or an issuer that is not an investment fund to obtain prior securityholder approval, with the fund prohibited from bearing the costs of the restructuring;

- proposed new paragraph 5.6(1)(k) will include a new condition that the consideration offered to securityholders of an investment fund for a merger have a value that is equal to the NAV of the fund if the merger is to be effected without prior securityholder or regulatory approval;

- subsection 5.6(2) is proposed to be repealed, as Regulation 81-106 requires that the auditor's report that accompanies financial statements of an investment fund not contain a reservation;

- proposed section 9.1 will prohibit the issuance of warrants and similar instruments by all investment funds;

- proposed subsections 9.3(2) and (3) will apply to an exchange-traded mutual fund that is not in continuous distribution to prevent dilutive issuances of securities;

- proposed subsections 10.4(1.3) and 10.6(2) will require an exchange-traded mutual fund that is not in continuous distribution to pay redemption proceeds no more than 15 business days after the redemption is effected, unless the redemptions of the fund have been suspended in accordance with the requirements in section 10.6; and

- draft amendments to Part 11 will permit cash received in respect of sales and redemptions of all investment fund securities (and not only mutual fund securities) to be held in one trust account.

We are also considering requirements for investment funds governed only by Regulation 81-102 to include specific identifiers in their name (see "(xiii) Naming Convention for Investment Funds" above).

Adoption Procedures

We expect the Draft Amendments to be incorporated as part of rules in each of British Columbia, Alberta, Manitoba, Ontario, Nova Scotia, Prince Edward Island, New Brunswick, Newfoundland and Labrador, Northwest Territories, Yukon and Nunavut, and incorporated as part of commission regulations in Saskatchewan and regulations in Québec. The Draft Policy Statement 81-102 Amendments are expected to be adopted as part of policies in each of the CSA jurisdictions.

Alternatives Considered to the Draft Amendments

The alternative to the Draft Amendments would be not to cover non-redeemable investment funds in Regulation 81-102 and thus maintain the status quo.

Not proceeding with the Draft Amendments would continue to permit non-redeemable investment funds to operate without a set of core operational requirements, such as certain conflicts of interest prohibitions, securityholder and regulatory approval requirements for fundamental changes and custodianship requirements. We think this alternative would not be appropriate in view of the investor protection and fairness concerns arising from the lack of baseline protections for investors of non-redeemable investment funds. Without the Draft Amendments, there would also be less certainty and consistency for non-redeemable investment funds and their managers regarding the operational requirements that they must follow.

Anticipated Costs and Benefits of the Draft Amendments

We think the Draft Amendments strike the right balance between protecting investors and fostering fair and efficient capital markets. The Draft Amendments will benefit investors and the capital markets by creating a more consistent, fair and functional regulatory regime across the spectrum of investment fund products.

Core operational requirements for non-redeemable investment funds and a more comprehensive regulatory framework for alternative funds will increase the efficiency for the investment fund industry by enabling them to offer products in a more timely fashion, as the requirements applicable to all publicly offered investment funds will be more clearly delineated for managers, investors and the market generally. We also think that the Draft Amendments will level the playing field for all investment funds.

The CSA are of the view that the Draft Amendments will not create substantial costs for investment funds, their managers or securityholders. Many of the Draft Amendments codify prevailing investment parameters and limits within the non-redeemable investment fund industry. Our review of existing non-redeemable investment funds indicates that a majority of non-redeemable investment funds already follow investment restrictions that are comparable to the proposed investment restrictions in Regulation 81-102. Further, many managers either manage various types of investment fund products (including mutual funds subject to Regulation 81-102) or have already established the necessary infrastructure to monitor compliance with the investment restrictions included in the constating documents of their funds. Therefore, these managers are already equipped to monitor compliance with any additional investment restrictions.

Introducing fundamental investor rights and protections may involve additional costs for non-redeemable investment funds, their managers or their securityholders. We think that the costs associated with providing investors with fundamental rights and protections are proportionate and do not outweigh the benefits. Areas where there may be a cost burden include:

- the proposal to prohibit a non-redeemable investment fund or its securityholders from paying the organizational costs of a new non-redeemable investment fund may require managers to finance the organizational costs of new funds. Managers could reconsider how they charge fees to their funds or securityholders if they pay the costs of launching a new fund;

- the proposed application of the securityholder voting requirements in Part 5 of Regulation 81-102 to non-redeemable investment funds may result in additional costs. Similar to our view on the importance of providing mutual fund investors with the right to vote on fundamental changes, we think that Part 5 provides important protection for investors of non-redeemable investment funds that would outweigh the associated costs. We also do not expect managers to implement fundamental changes on a frequent basis; and

- the proposed prohibition on warrant issuances to protect existing investors of an investment fund from dilutive offerings may result in increased costs if managers have to look for other ways of increasing their assets under management. We expect that managers will raise additional money through offerings of new securities of the fund, rather than through warrant offerings. As managers may still raise additional money through new offerings, we think that this prohibition does not represent an undue

restriction on managers and that the investor protection benefits from this proposed prohibition outweigh the costs.

Overall, we think the potential benefits of the Draft Amendments are proportionate to their costs. We seek feedback on whether you agree or disagree with our perspective on the cost burden of the Draft Amendments, as well as your views on the cost burden of implementing other elements of the Modernization Project, including the proposed reform of Regulation 81-104 described below. Specific quantitative data in support of your views in this context would be particularly helpful.

Modernization Project – Alternative Funds Framework

Together with the CSA's introduction of core operational requirements for publicly offered non-redeemable investment funds, we are considering amendments to Regulation 81-104 to include both mutual funds and non-redeemable investment funds that focus on alternative asset classes or use alternative investment strategies not permitted by proposed amended Regulation 81-102.

Currently, Regulation 81-104 sets forth a regulatory framework that applies only to specialized mutual funds that are commodity pools by exempting them from certain restrictions in Regulation 81-102. A redesign of Regulation 81-104 to include both mutual funds and non-redeemable investment funds is intended to preserve the flexibility for non-redeemable investment funds to use alternative investment strategies that may not be permissible under the Draft 81-102 Amendments, and at the same time, create a more comprehensive regulatory framework in Regulation 81-104 for alternative funds (both mutual funds and non-redeemable investment funds). Any amendments to Regulation 81-104 will also seek to help investors more effectively differentiate between investment funds that use alternative investment strategies from investment funds that use more conventional investment strategies.

As part of our review of Regulation 81-104, we are examining the current exemptions from Regulation 81-102 that are contained in Regulation 81-104 to determine whether each exemption should remain and what, if any, new exemptions should be added. We are also considering new disclosure requirements in the prospectus, continuous disclosure and sales communications for investment funds that wish to use the alternative investment strategies in Regulation 81-104 and whether there is a need for additional proficiency requirements for the sale of alternative fund securities.

We have set out below the key elements of a proposed regulatory framework in Regulation 81-104 on which we seek feedback. This will inform the rule-making relating to Regulation 81-104 and the proposed investment restrictions in Regulation 81-102, as the two frameworks are intended to work in conjunction with each other to allow a wide variety of investment funds to be offered to the public. After reviewing your feedback, we will publish draft amendments to Regulation 81-104 for comment. Based on the feedback received, we may also publish for comment modifications to certain of the Draft 81-102 Amendments that interact with draft amendments to Regulation 81-104.

Feedback is welcome on all aspects of the proposed regulatory framework in Regulation 81-104 being considered by the CSA. A consolidated list of the specific issues on which we seek feedback is set out in Annex B.

(i) Definition of "Alternative Fund"

The CSA contemplate that Regulation 81-104 would apply to

- an "alternative fund" to which Regulation 81-102 applies, and
- a person in respect of an alternative fund to which Regulation 81-104 applies.

The CSA are considering replacing the term "commodity pool" in Regulation 81-104 with "alternative fund", a term that we think will better describe the types of investment objectives or strategies that characterize the investment funds that would be subject to the amended Regulation 81-104. Alternative funds will be permitted to invest in certain asset classes and use certain strategies not permitted by Regulation 81-102 by virtue of exemptions from Regulation 81-102 that will be contained in Regulation 81-104. We seek feedback on the use of the term "alternative fund" and whether it accurately describes the types of funds that would be expected to be captured by Regulation 81-104.

The current definition of "commodity pool" in Regulation 81-104 refers to a mutual fund that has adopted fundamental investment objectives that permit it to use or invest in specified derivatives or physical commodities in a manner not permitted by Regulation 81-102. The CSA are considering defining an "alternative fund" as an investment fund that, in its initial prospectus, states that it is an alternative fund in response to Item 1.3(1) of Form 41-101F2. Both mutual funds and non-redeemable investment funds could be alternative funds if they satisfy the definition.

(ii) Investment Restrictions

Concentration Restriction

To allow investment funds greater flexibility to engage in alternative investment strategies, we are considering permitting alternative funds to invest a larger percentage of their NAV in securities of a single issuer than the proposed 10% restriction in Regulation 81-102. Depending on the comments received on the Draft 81-102 Amendments, non-redeemable investment funds may become subject to a higher concentration restriction than 10% under Regulation 81-102, and this may impact the concentration restriction under Regulation 81-104. See "Summary of Draft Amendments" above. We seek feedback on the types of investment strategies an alternative fund may engage in that would require a fund's investment in an issuer to exceed the current 10% concentration restriction in Regulation 81-102.

Also, given that we anticipate alternative funds having more leveraged exposure than investment funds that invest within the limits in Regulation 81-102, we are considering whether the concentration measurement in section 2.1 of Regulation 81-102 based on the net asset value is a sufficient measurement to provide information about the concentration of an alternative fund's

portfolio. We seek feedback on whether there are other ways that would better describe the level of concentration of an alternative fund portfolio.

Investments in Physical Commodities

The CSA are considering maintaining the current exemptions from paragraphs 2.3(d), (e), (f), (g) and (h) of Regulation 81-102 in Regulation 81-104. We think that Regulation 81-104 should similarly permit alternative funds structured as non-redeemable investment funds to invest in physical commodities and specified derivatives linked to physical commodities in the same way as commodity pools currently do today. The CSA expect that investment funds that primarily focus on investing in physical commodities through direct holdings or through specified derivatives would be alternative funds subject to Regulation 81-104.

Currently, there are mutual funds that have received exemptive relief from Regulation 81-102 to be "precious metals funds" because their fundamental investment objectives provide that they invest primarily in gold, silver or platinum. We do not expect these funds to be impacted by our consideration of draft amendments to Regulation 81-104.

Fund-of-Fund Structures

Generally, we are considering permitting an alternative fund to invest in underlying investment funds (including underlying alternative funds) subject to similar conditions applicable to fund-of-fund investments in section 2.5 of Regulation 81-102.

The application of paragraphs 2.5(2)(a) and (c) of Regulation 81-102 to alternative funds would mean that an alternative fund that wishes to use a fund-of-fund structure may invest only in underlying mutual funds that are reporting issuers in the same jurisdictions as the alternative fund. The CSA are not at this time contemplating the inclusion of an exemption from paragraphs 2.5(2)(a) and (c) in Regulation 81-104 to permit alternative funds to invest in underlying funds that are not reporting issuers. We are of the view that fund-of-fund structures that involve investing in underlying investment funds that are not reporting issuers in the same jurisdictions as the alternative fund (e.g., underlying funds that are foreign investment funds or Canadian-based investment funds that are offered under prospectus exemptions) are more appropriately addressed through discretionary exemptive relief for each specific structure proposed to be offered.

Borrowing

The CSA are considering whether alternative funds should be permitted to borrow cash beyond the proposed 30% limit for non-redeemable investment funds in Regulation 81-102. If alternative funds are permitted to borrow a greater amount of cash, we are considering a limit that would not exceed 50% of NAV at the time of borrowing. We seek feedback on whether alternative funds that are structured as mutual funds and those that are structured as non-redeemable investment funds should have different borrowing restrictions in Regulation 81-104, in light of a mutual fund's need to fund regular redemptions.

Short Selling

The CSA are considering permitting alternative funds to sell securities short beyond the limits in Regulation 81-102 to provide these funds with more flexibility to use long/short strategies. We

are considering limiting the aggregate market value of all securities of an issuer that may be sold short by an alternative fund to 10% of the NAV of the fund, calculated at the time of the short sale. As well, we are considering restricting the aggregate market value of all securities that may be sold short by an alternative fund to 40% of the NAV of the fund, calculated at the time of a short sale. These limits would be similar to those imposed in orders that granted exemptive relief to commodity pools to permit them to short sell. We are also considering including an exemption in Regulation 81-104 from the short selling conditions in subsections 2.6.1(2) and (3) of Regulation 81-102, which require funds to hold cash cover and prohibit the use of short sale proceeds to purchase securities other than securities that qualify as cash cover. We seek feedback on whether alternative funds should be permitted to short sell on this basis.

Use of Derivatives

We contemplate maintaining the current exemption from sections 2.8 and 2.11 of Regulation 81-102 in Regulation 81-104 to permit alternative funds to create leverage through using specified derivatives. This exemption would apply to both mutual funds and non-redeemable investment funds that are alternative funds.

Leveraged Daily Tracking Alternative Funds

In recent years, the CSA have observed offerings of investment funds (Leveraged Daily Tracking Alternative Funds) that seek to provide daily investment returns that are up to two times the daily positive or inverse return of an underlying interest (e.g., an index, commodity price, interest rate or exchange rate) that they track. When held for periods longer than one day, the return of these funds may differ from the multiple or inverse multiple of the return of the relevant underlying interest over the longer period. These differences may be inconsistent with investor expectations.

The CSA are considering introducing a restriction on alternative funds from providing returns of more than two times the existing daily positive or inverse return of an underlying interest. We also seek feedback on issues relating to the marketing of Leveraged Daily Tracking Alternative Funds, as well as issues relating to the proficiency of individual dealing representatives who sell securities of Leveraged Daily Tracking Alternative Funds and dealer supervision of trades in securities of these funds.

Counterparty Credit Exposure

We are considering whether the exemption from subsections 2.7(4) and (5) of Regulation 81-102 (the Counterparty Exposure Exemption) in Regulation 81-104 should be repealed. The repeal of the Counterparty Exposure Exemption will restrict an alternative fund from having a mark-to-market exposure under its specified derivatives positions with any one counterparty other than an acceptable clearing corporation or a clearing corporation that settles transactions made on a futures exchange listed in Appendix A to Regulation 81-102 (the Clearing Corporation Exception), which exceeds, for a period of 30 days or more, 10% of the NAV of the alternative fund. The existing Clearing Corporation Exception in subsection 2.7(4) of Regulation 81-102 would permit alternative funds to continue to use investment strategies based on standardized futures.

Repealing the Counterparty Exposure Exemption would be intended to reduce the risk of exposure to a single counterparty, particularly in connection with illiquid over-the-counter

(OTC) derivatives. Where an alternative fund's exposure to a counterparty constitutes a significant amount of the fund's NAV, we think that the risks associated with such exposure, particularly the credit risk of the counterparty, may materially alter the nature and risk profile of the fund.

We also note that large counterparty exposures through OTC derivatives may be inconsistent with the restrictions on investments in illiquid assets, as Regulation 81-104 does not exempt commodity pools from the restriction in section 2.4 of Regulation 81-102.

We seek feedback on the impact of this approach to existing commodity pools that may be relying on the Counterparty Exposure Exemption and whether the repeal of this exemption would appropriately mitigate the risks of counterparty exposure, or whether there are other ways to achieve the desired outcome.

Total Leverage Limit

Limit

The CSA are considering introducing a total leverage limit for alternative funds in Regulation 81-104. Alternative funds may employ leverage through a number of ways including borrowing, short selling and derivatives transactions; also, they may obtain leveraged exposure through investing in underlying funds that employ leverage. Although the provisions relating to each investment strategy may specify limits for each strategy, we are considering creating a single cap on the total amount of leverage an alternative fund may create through leveraged investment strategies. The cap would include the leverage obtained through investing in underlying funds that employ leverage.

We are considering a total leverage limit for alternative funds of 3:1, based on the leverage calculation method currently specified in Form 41-101F2. The proposed 3:1 limit would be required to be respected by an alternative fund at all times, and not only at the time of entering into a transaction that creates leverage. We seek feedback on this proposed limit and whether the total leverage limit should be the same for mutual funds and non-redeemable investment funds, having regard to a mutual fund's need to fund regular redemptions.

Leverage Measurement Methods

Form 41-101F2 currently requires the maximum leverage an investment fund may use to be disclosed as a ratio of total long positions (including leveraged positions) plus total short positions divided by the net assets of the investment fund. This calculation has the benefit of presenting a single number that may be readily understood by retail investors. The drawback to this measure is that it may not fully express the nature of the leverage applicable to an alternative fund, as leverage created through different means may have different impact. For example, a leveraged position created through using standardized futures may be closed quickly by entering into an offsetting position, while leverage created through borrowing may be more difficult to reduce. Leverage through purchasing a call option differs from leverage through a long position

in a forward contract since the former does not create future payment obligations. Other aspects of particular investment strategies may also complicate the calculation of leverage.

We are considering whether there are other methods of measuring leverage and invite feedback on this.

Other Investment Restrictions for Alternative Funds
Other than the investment restrictions discussed above, the CSA seek feedback on whether there are additional investment strategies that Regulation 81-104 should permit or restrict for alternative funds.

(iii) New Alternative Funds

Seed Capital and Organizational Costs
The CSA are considering the requirements applicable to the launch of new alternative funds. We are considering adopting a model for alternative funds that is substantially similar to Part 3 of Regulation 81-102. We are considering a model under which sections 3.1 to 3.3 of Regulation 81-102 would apply to the launch of a new alternative fund that is a mutual fund, except that:

- the minimum amount specified in subsection 3.1(2) of Regulation 81-102 that must be received by the fund before redemptions may be processed would be raised from $500,000 to $5,000,000 for an alternative fund; and

- the manager of the alternative fund (or the persons specified in subsection 3.1(1) of Regulation 81-102, who, together with the manager of the alternative fund, are referred to as "sponsors") would be required to provide seed capital of $150,000, instead of the $50,000 in seed capital currently required for commodity pools under section 3.2 of Regulation 81-104.

Under the proposed model, sponsors that launch new alternative funds that are non-redeemable investment funds would only have to comply with proposed amended section 3.3 of Regulation 81-102 (see "Summary of Draft Amendments – (iii) New Non-Redeemable Investment Funds").

On-going Investment by Sponsors
Subsection 3.2(2) of Regulation 81-104 restricts a commodity pool from redeeming securities unless the securities issued to sponsors remain outstanding and the sponsors maintain a $50,000 investment in the commodity pool.

In recent years, exemptive relief has been granted to permit sponsors of a commodity pool to withdraw their seed capital investment in the commodity pool, provided that:

- the commodity pool has received $5,000,000 in subscriptions from investors other than the sponsors; and

- if the value of the commodity pool units subscribed to by investors other than the sponsors drops below $5,000,000 for more than 30 consecutive days, the sponsors

reinvest the seed capital amount and maintain that investment until the value of the commodity pool units subscribed to by investors other than the sponsors exceeds $5,000,000.

We are considering whether to eliminate the restriction in subsection 3.2(2) of Regulation 81-104 and permit sponsors to withdraw their seed capital investment in alternative funds, subject to the same conditions for the exemptive relief described above. We are also seeking feedback on whether sponsors should be required to maintain an on-going investment in alternative funds.

(iv) Proficiency

Currently, Part 4 of Regulation 81-104 requires mutual fund restricted individuals (as defined in Regulation 81-104) who sell commodity pool securities to have qualifications in addition to those for selling mutual fund securities. In particular, a mutual fund restricted individual may only trade in a security of a commodity pool if that individual meets the additional proficiency standards set out in subsection 4.1(1) of Regulation 81-104. Part 4 also imposes proficiency requirements for dealer supervision of trades in commodity pool securities.

Given the unique features that will characterize alternative funds such as the increased flexibility to create leverage and engage in potentially more complex strategies, the CSA are considering whether further proficiency requirements should apply to all individual dealing representatives who sell alternative fund securities. For example, these individuals could be required to have additional experience or to have passed additional courses. We seek feedback on whether and what additional proficiency requirements could apply.

(v) Enhanced Disclosure and Transparency

A key element of the CSA's proposal for a more robust framework for alternative funds is to provide clarity for investors and the market by more effectively differentiating between alternative funds and investment funds subject only to Regulation 81-102. To achieve this, we are considering the introduction of specific requirements relating to the naming, prospectus disclosure, sales communications, and continuous disclosure of alternative funds, as set out below.

Naming Convention

We are considering requiring all alternative funds to have the words "Alternative Fund" in their name. This requirement would apply to existing commodity pools and other investment funds that wish to gain access to the Regulation 81-104 framework, subject to a transition period. We seek feedback on whether there are identifiers other than including "Alternative Fund" in the name of the alternative fund that would achieve the same purpose. In addition, we are considering whether alternative funds that list and trade their securities on an exchange should be required to use trading symbols or a suffix to the symbol that would more readily identify the fund as an alternative fund.

Prospectus Disclosure
The CSA anticipate that alternative funds would file a prospectus using Form 41-101F2. To further differentiate alternative funds from conventional investment funds, the CSA are considering introducing a disclosure item in Form 41-101F2 that would require the inclusion of a prescribed text box in bold text in a specified font size on the cover page of the prospectus of an alternative fund, as follows:

> This fund is an alternative fund. This fund may use investment strategies or invest in assets in a different manner than other investment funds. The risks of investing in this fund may differ significantly from the risks associated with other investment funds.
>
> These brief statements do not disclose all the risks and other significant aspects of investing in this fund. You should carefully read this prospectus, including the description of the principal risk factors before you decide to invest.

In addition, we are considering requiring an alternative fund to disclose in its prospectus under the "Investment Strategies" heading how its investment strategies differ from those of a conventional investment fund under Regulation 81-102.

Finally, we are also considering prohibiting an alternative fund from being offered in the same prospectus document with investment funds that are not alternative funds.

Sales Communications
The CSA are considering introducing specific sales communication disclosure requirements to Regulation 81-104 to assist investors and market participants in distinguishing alternative funds from other types of investment funds. Similar to the text box disclosure on the cover page of the prospectus, we are considering a requirement for all sales communications for alternative funds to include a text box at the top of the first page of any sales communication or at the beginning of a sales communication that is not in printed form, with the following content:

> This fund is an alternative fund. This fund may use investment strategies or invest in assets in a different manner than other investment funds. The risks of investing in this fund may differ significantly from the risks associated with other investment funds.

We are also considering prohibiting alternative funds from comparing themselves to other types of investment funds in their sales communications. The CSA have observed comparisons between commodity pools and mutual funds, for example, that do not present a fair and balanced picture of the respective benefits and risks associated with each type of fund.

Continuous Disclosure
As alternative funds will have more flexibility to generate leverage and engage in more complex strategies, the CSA are considering whether investors may benefit from more frequent financial reporting and tailored disclosure of how specific investment strategies have affected the returns

of an alternative fund. Increased transparency could also help investors and their advisers monitor the risks of the funds they have chosen.

Monthly Website Disclosure

To supplement the existing quarterly information required under Regulation 81-106, we are considering requiring an alternative fund to disclose publicly on its or its fund manager's website, on a monthly basis (with an appropriate time lag for the manager to prepare the information), the largest monthly and annual NAV drawdowns of the alternative fund in the past five years, or since inception if the alternative fund has been in existence for less than five years.

We are also considering whether to require an alternative fund to disclose its maximum and average daily leverage amounts during the most recent 12 month period. These reports would be updated on a monthly basis (also with an appropriate time lag for the manager to update the information) and be posted on the fund's or its manager's website.

We seek feedback on whether the proposed monthly disclosure of NAV drawdown and leverage information for alternative funds will be useful to investors or the market generally. We also seek feedback on whether there is other information that could be provided regularly on an alternative fund's or its manager's website that would be meaningful for investors.

Semi-Annual and Annual Disclosure

In addition to the disclosure regarding borrowing under subsection 3.6(2) of Regulation 81-106, we are also considering amending the semi-annual and annual disclosure requirements in Regulation 81-106 to require tailored disclosure relating to an alternative fund's use of investment strategies that create leverage. For example, alternative funds could be required to disclose the maximum amount of leverage and the average amount of leverage used during the reporting period. The additional disclosure could also contain a qualitative explanation of how leverage was employed during the reporting period.

(vi) Transition

The CSA recognize that existing commodity pools, as well as non-redeemable investment funds that currently use investment strategies that may not be permitted under the Draft 81-102 Amendments, may seek to become alternative funds under the new definition. We think that existing investment funds should disclose to their investors and the market their intent to become alternative funds under Regulation 81-104. We seek feedback on the steps that existing investment funds should take for transitioning into the alternative funds framework provided in the revised Regulation 81-104.

We anticipate that existing investment funds that wish to transition into the alternative funds framework will be given sufficient time to take the necessary steps to make the transition. We anticipate that there would be a transition period proposed for comment, the design of which will depend on feedback received on the requirements for transition.

Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

In connection with our proposal to apply the framework for securities lending, repurchases and reverse repurchases in Regulation 81-102 to non-redeemable investment funds, we also reviewed the existing requirements in Regulation 81-102 and Regulation 81-106 relating to securities lending, repurchases and reverse repurchases in light of the recent international focus on these activities to examine whether the existing requirements continue to keep pace with international standards.[11] While we think that the current operational requirements are generally comparable to existing standards in other international jurisdictions, as a result of this review, we are considering additional rules to enhance the transparency of the returns, costs and risks of securities lending, repurchases and reverse repurchases by investment funds, particularly where conflicts of interest may arise in connection with these activities.

Please refer to Annex C for specific questions for which we seek feedback to inform our consideration of amendments to the requirements relating to securities lending, repurchases and reverse repurchases by investment funds.

We will also continue to monitor global regulatory developments relating to securities lending, repurchases and reverse repurchases by investment funds.

Local Matters

An Annex is being published in any local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Unpublished Materials

In developing the Proposed Provisions, we have not relied on any significant unpublished study, report or other written materials.

Request for Comments and Feedback

We are soliciting comment on the Draft Amendments. As well, we are seeking feedback on the proposals being considered for an alternative fund regime under Regulation 81-104 and the proposals being considered in relation to securities lending, repurchases and reverse repurchases by investment funds. We have identified specific issues in Annexes A to C to this Notice.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. All comments will be posted on the OSC website at www.osc.gov.on.ca.

Please submit your comments in writing on or before June 25, 2013. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

[11] See note 5 above.

Where to Send Your Comments

Address your submission to all of the CSA as follows:

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

Please send your comments only to the addresses below. Your comments will be forwarded to the other CSA members.

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
Fax: 514-864-6381
Email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Questions

Please refer your questions to any of the following people:

Hugo Lacroix
Senior Analyst, Investment Funds Branch
Autorité des marchés financiers
514-395-0337, ext. 4476
hugo.lacroix@lautorite.qc.ca

Mostafa Asadi
Legal Counsel, Investment Funds Branch
Ontario Securities Commission
416-593-8171
masadi@osc.gov.on.ca

Chantal Leclerc
Lawyer / Senior policy advisor
Autorité des marchés financiers
514-395-0337, ext. 4463
chantal.leclerc@lautorite.qc.ca

Noreen Bent
Manager and Senior Legal Counsel
Legal Services, Corporate Finance
British Columbia Securities Commission
604-899-6741
nbent@bcsc.bc.ca

Christopher Birchall
Senior Securities Analyst
Corporate Finance
British Columbia Securities Commission
604-899-6722
cbirchall@bcsc.bc.ca

Bob Bouchard
Director and Chief Administration Officer
Manitoba Securities Commission
204-945-2555
Bob.Bouchard@gov.mb.ca

Raymond Chan
Manager, Investment Funds Branch
Ontario Securities Commission
416-593-8128
rchan@osc.gov.on.ca

Donna Gouthro
Securities Analyst
Nova Scotia Securities Commission
902-424-7277
gouthrdm@gov.ns.ca

Pei-Ching Huang
Senior Legal Counsel, Investment Funds Branch
Ontario Securities Commission
416-593-8264
phuang@osc.gov.on.ca

George Hungerford
Senior Legal Counsel, Legal Services, Corporate Finance
British Columbia Securities Commission
604-899-6690
ghungerford@bcsc.bc.ca

Ian Kearsey
Legal Counsel, Investment Funds Branch
Ontario Securities Commission
416-593-2169
ikearsey@osc.gov.on.ca

Ian Kerr
Senior Legal Counsel, Corporate Finance
Alberta Securities Commission
403-297-4225
Ian.Kerr@asc.ca

Carina Kwan
Legal Counsel, Investment Funds Branch
Ontario Securities Commission
416-593-8052
ckwan@osc.gov.on.ca

Agnes Lau
Senior Advisor - Technical & Projects,
Corporate Finance
Alberta Securities Commission
403-297-8049
Agnes.Lau@asc.ca

Contents of Annexes

The text of the Proposed Provisions is contained in the following annexes to this Notice and is available on the websites of members of the CSA:

Annex A: Specific Questions of the CSA relating to the Draft 81-102 Amendments

Annex B: Specific Questions of the CSA relating to the Alternative Funds Framework in Regulation 81-104

Annex C: Specific Questions of the CSA relating to Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

Annex D: Summary of Public Comments on Phase 2 Proposals for the Modernization Project

Annex A

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

Annual Redemptions of Securities Based on NAV

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

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

Investment Restrictions

Concentration Restriction

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

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

Investments in Illiquid Assets

3. As non-redeemable investment funds do not redeem their securities regularly based on NAV, the CSA propose that they be permitted to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of Regulation

81-102. However, we are concerned that a portfolio containing a significant amount of illiquid assets could lead to difficulties in valuing the NAV of the fund. It is critical that the NAV of an investment fund be accurately valued; for example, non-redeemable investment funds typically pay management and other fees based on the NAV of the fund, NAV is used to measure performance, and many non-redeemable investment funds offer annual redemptions based on NAV.

We have observed that many non-redeemable investment funds do not invest in a substantial amount of illiquid assets; in fact, the majority of non-redeemable investment funds, like mutual funds, hold minimal amounts of illiquid assets. Would the ability to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of Regulation 81-102 be beneficial for non-redeemable investment funds? What types of illiquid assets do non-redeemable investment funds wish to invest in, and why?

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

Borrowing

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

Investments in Mortgages

5. We invite comment on the impact of the proposed restriction on investments in non-guaranteed mortgages for publicly offered non-redeemable investment funds. We also seek feedback on the transition period for the proposed restriction. If you consider that a transition period longer than 24 months is required, please explain why. Alternatively, if you think that a grandfathering provision is warranted to exempt these types of funds from the application of the proposed restriction on investments in non-guaranteed mortgages, please comment on the impact such a provision could have on fairness to new market participants and investor understanding.

Fund-of-Fund Structures

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

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

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

Under proposed amended paragraph 2.5(2)(c) of Regulation 81-102, the underlying fund must be a reporting issuer in all the jurisdictions in which the non-redeemable investment fund is a reporting issuer. This is intended to prevent an indirect distribution of the securities of the underlying fund in jurisdictions where the underlying fund has not filed a prospectus and to ensure that the local jurisdiction has authority over both the top fund and the underlying fund. Should proposed amended paragraph 2.5(2)(c) apply to non-redeemable investment funds that use a fund-of-fund structure? If not, why not? What other parameters could be used to address the CSA's objectives?

Organizational Costs of New Non-Redeemable Investment Funds

8. We seek comment on the impact and the benefits and costs of proposed subsection 3.3(3) of Regulation 81-102. Are there other parameters that could be developed that would achieve benefits similar to the benefits from proposed subsection 3.3(3)? Please also comment on whether the capital raising model followed by non-redeemable investment funds could support the payment of some of the organizational costs out of the proceeds of the initial public offering. Are there specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the

manager? Please provide information about these cost components and what fraction each component typically constitutes of the total organizational costs for launching a new fund, and explain why it is appropriate for the fund or the manager to pay the specific cost components.

Dilutive Issuances of Securities

9. The CSA propose to introduce subsection 9.3(2) to prevent issuances of securities that cause dilution to the NAV of other outstanding securities of a non-redeemable investment fund. Proposed subsection 9.3(3) recognizes that a non-redeemable investment fund that raises additional money from the public through a new issuance of securities must include the price of the securities in the prospectus. We invite comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.

Naming Convention for Investment Funds

10. Please see question 13 in Annex B.

Transition Period for Investment Restrictions in Proposed Amended Regulation 81-102 and Alternatives

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

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

Anticipated Costs of the Proposed Amendments and of Implementing the Alternative Funds Framework

12. Do you agree or disagree that the costs of the Proposed Amendments and the proposals relating to Regulation 81-104 are proportionate to the benefits? We seek specific data from non-redeemable investment funds and commodity pools on the anticipated costs and benefits of complying with the regulatory framework set out in the proposed amendments to Regulation 81-102 and the alternative funds regulatory framework being contemplated in Regulation 81-104.

[1] Other than proposed paragraph 2.3(2)(b). See question 5 above.

Annex B

Specific Questions of the CSA relating to the Alternative Funds Framework in Regulation 81-104

Definition of "Alternative Fund"

1. Does the use of the term "alternative fund" appropriately describe the types of investment funds that should be captured by Regulation 81-104? If not, please propose other terms that better describe the types of investment funds that use investment strategies that should be permitted under a revised version of Regulation 81-104.

Investment Restrictions

Concentration Restriction

2. We seek feedback on the types of investment strategies an alternative fund may engage in that would require a fund's investment in an issuer to exceed the current 10% concentration restriction in proposed amended Regulation 81-102. If you think that the concentration restriction under Regulation 81-104 should be higher than the current 10% issuer concentration limit in Regulation 81-102, please provide feedback on what an appropriate concentration restriction would be for alternative funds. See also question 2 in Annex A.

3. Given that we anticipate alternative funds having more leveraged exposure than is permissible under Regulation 81-102, should we consider other measurements for an alternative fund's concentration? Should issuer concentration for alternative funds be based on the total notional exposure of the fund? We seek feedback on this and other measurements that would better describe the level of concentration in an alternative fund portfolio.

Borrowing

4. Should alternative funds that are structured as mutual funds and alternative funds that are structured as non-redeemable investment funds have different borrowing restrictions in Regulation 81-104? Would a mutual fund's need to fund regular redemptions mean that the amount of leverage through cash borrowings could increase rapidly and cause difficulties in maintaining the 3:1 total leverage limit we are considering?

Short Selling

5. Should Regulation 81-104 include exemptions from subsections 2.6.1(2) and (3) of Regulation 81-102 to permit the creation of leverage through short selling and increase flexibility for alternative funds to engage in long/short strategies?

Leveraged Daily Tracking Alternative Funds

6. Are there specific issues relating to the marketing of Leveraged Daily Tracking Alternative Funds that the CSA should consider? Are there specific issues relating to the proficiency of individual dealing representatives who sell Leveraged Daily Tracking Alternative Fund securities and dealer supervision of trades in Leveraged Daily Tracking Alternative Fund securities that the CSA should consider?

Counterparty Credit Exposure

7. We seek feedback on the impact to existing commodity pools that are relying on the Counterparty Exposure Exemption if this exemption in Regulation 81-104 were to be repealed.

Would repealing the Counterparty Exposure Exemption sufficiently mitigate the risk of exposure to a single counterparty, particularly in connection with illiquid OTC derivatives? Are there other ways we should consider to mitigate counterparty risk; for example, by requiring the posting of collateral by the counterparty? If so, what requirements should apply to the use of collateral? If an alternative fund receives collateral from a counterparty to a specified derivatives transaction, should the collateral be considered in determining the alternative fund's exposure to the counterparty?

Total Leverage Limit

8. Do you agree with a total leverage limit for alternative funds of 3:1 based on the leverage calculation method currently specified in Item 6.1 of Form 41-101F2? If not, what should the total leverage limit of an alternative fund be, and why? Should the total leverage limit be lower for mutual funds that are alternative funds because of the need to fund regular redemptions?

9. What other leverage measurement methods could be used to inform investors of the amount of leverage used by alternative funds, other than the method currently specified in Item 6.1 of Form 41-101F2? Please also explain why the alternative leverage measurements you propose provide investors with a better understanding of the amount of leverage used by alternative funds.

Other Investment Restrictions for Alternative Funds

10. Are there other specific investment strategies that Regulation 81-104 should permit or restrict?

On-going Investment by Sponsors

11. Should the sponsors of an alternative fund be permitted to withdraw their seed capital investment in the alternative fund if the fund reaches a sufficient size? Or should the sponsors be required to maintain an investment in the alternative fund? We invite

feedback on why sponsors should be required to maintain an on-going investment in an alternative fund and the amount of on-going investment that would be appropriate.

Proficiency

12. Should additional proficiency requirements for all individual dealing representatives who sell securities of alternative funds be introduced? If yes, please provide specific examples of the courses or experience that should apply. If no, please explain.

Enhanced Disclosure and Transparency

Naming Convention

13. Would requiring an alternative fund to include the words "Alternative Fund" in its name achieve the purpose of distinguishing alternative funds from other investment funds for investors and the market? If not, please propose other ways to facilitate the ready identification of alternative funds.

In addition, would requiring investment funds governed only by Regulation 81-102 to include specific words (e.g., "Conventional Fund") in their name further this purpose? If not, why not? Would the diversity of investment funds that are governed only by Regulation 81-102 and their different risk levels impede the creation of a uniform descriptor for such funds?

Monthly Website Disclosure

14. We seek feedback on whether there are any impediments for an alternative fund to disclose on its or its manager's website on a monthly basis (with appropriate time lag for the manager to prepare the information) the fund's largest monthly NAV drawdown for the past five years and the maximum and average daily leverage employed during the most recent 12 month period. We further invite feedback on whether this information will be useful to investors or the market generally.

Is there other information that could be provided regularly on the website of the alternative fund or its manager that would be meaningful for investors or for the market?

Transition

15. How should the disclosure of an existing investment fund's intent to transition into the alternative fund regime in Regulation 81-104 be made? For example, should investors be provided with written notice or would a press release be sufficient? In addition to disclosing their intent to transition into the alternative fund regime, what other measures should be required for existing investment funds to transition into the alternative fund regime?

Costs and Benefits of Implementing Alternative Funds Framework

16. Please see question 12 in Annex A.

Annex C

Specific Questions of the CSA relating to Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

The CSA are considering measures to enhance the transparency of the benefits, costs and risks of securities lending, repurchase and reverse repurchase transactions conducted by investment funds. We seek feedback on the following issues.

The CSA understand that it is common practice for securities lending agents to be compensated through receiving a share of the revenue generated from lending securities, repurchases and, if a lending agent is used, reverse repurchases. We also understand that some managers have established revenue-sharing arrangements under which revenue is shared between the investment fund and a lending agent related to the manager or between the investment fund and the manager. As the investment fund bears all the risks from securities lending, repurchases and reverse repurchases, the CSA are of the view that the revenue from engaging in these activities, after the payment of costs for conducting the activities, should be received only by the investment fund.

Currently, depending on the terms of the securities lending agreement, the financial statements of an investment fund that engages in securities lending may disclose the revenue from securities lending net of the lending agent's share. Further, in such cases, the amount paid to the lending agent does not appear in the financial statements as a cost of conducting the activities.

While the amount of revenue generated by securities lending and repurchases may be relatively small, the CSA are of the view that because mutual funds (and, under the Proposed 81-102 Amendments, all investment funds) may lend, or sell in repurchase transactions, up to 50% of total assets,[1] information about the returns, costs and risks of securities lending and repurchase activity is relevant to investors.

The CSA think that it is important for investors to understand the returns from securities lending and how such revenue has contributed to the performance of the investment funds. We also think it is important for investors to be aware of the costs, the profitability and the scope of an investment fund's securities lending activities, so that they can assess the efficiency of the lending. Transparency of the revenue and cost is particularly important if the investment fund uses a lending agent that is related to the manager, which may give rise to conflicts of interest. Further, if the related lending agent shares in the revenue from securities lending, the manager could market its funds to investors as having a management fee that is lower than it would otherwise be, without investors being aware of the additional compensation paid to the affiliated lending agent through the revenue sharing arrangement.

---

[1] The CSA are proposing to change the limit on the amount of securities loaned, or sold in repurchases, by all investment funds from 50% of total assets (excluding collateral delivered to the fund) to 50% of NAV. See "Summary of Proposed Amendments – (ii) Investment Restrictions – Securities Lending, Repurchases and Reverse Repurchases".

Accordingly, we are considering measures to enhance the transparency of the benefits from securities lending and the costs paid to earn the returns. We are of the view that disclosure of the gross returns from, and the costs of, securities lending would provide additional transparency.

We seek feedback on approaches that would achieve the outcome of providing disclosure of the gross returns and the costs of securities lending.

1. Are there other costs of conducting securities lending, other than the fee paid to the lending agent?

2. What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the revenue from securities lending inclusive of the share paid to the agent? What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the costs of securities lending?

3. What approaches could the CSA consider to ensure that the costs of securities lending are included in either the management expense ratio or the trading expense ratio of the investment fund?

4. We think that the disclosure of the returns and the costs of repurchases should be the same as the disclosure of securities lending, since both activities are substantively similar. Should the same type of disclosure for reverse repurchases be provided? Should the returns and costs of securities lending and repurchases be aggregated, rather than disclosed separately?

5. In order to provide investors with transparency on the profitability and scope of an investment fund's securities lending and repurchase activities, the CSA are considering requiring the following additional disclosure, in the investment fund's management reports of fund performance, regarding such activities:

- The average daily aggregate dollar value of securities lent (or sold in repurchase transactions) obtained by

    (i) adding together the aggregate dollar value of portfolio securities that were lent (or sold) in the securities lending (or repurchase) transactions of the investment fund that are outstanding as at the end of each day during the financial year or interim period; and

    (ii) dividing the amount obtained under (i) by the number of days during the financial year or interim period.

- The percentage profitability of securities lending (or repurchase transactions) obtained by

    (i) dividing the revenue from securities lending (or repurchase) transactions during the financial year or interim period by the average daily aggregate dollar value of securities lent (or sold in repurchase transactions); and

(ii) multiplying the amount obtained under (i) by 100.

- The percentage return from securities lending (or repurchase transactions) obtained by

  (i) dividing the securities lending (or repurchase) revenue by the average net asset value of the investment fund during the financial year or interim period; and

  (ii) multiplying the amount obtained under (i) by 100.

- The percentage of net asset value lent (or sold) obtained by

  (i) dividing the average daily aggregate dollar value of securities lent (or sold in repurchase transactions) by the average net asset value of the investment fund during the financial year or interim period; and

  (ii) multiplying the amount obtained under (i) by 100.

- The maximum amount of securities lent (and sold in repurchase transactions) in any day during the financial year or interim period, both as a dollar amount and as a percentage of net asset value on that date.

Do you agree that these disclosure items are useful in increasing transparency regarding the profitability and scope of a fund's securities lending and repurchases? Are any of these items less useful to investors, in light of the costs to the investment fund of calculating and disclosing them?

6. Are there any other measurements regarding securities lending, repurchases or reverse repurchases that would provide useful information to investors in addition to, or in lieu of, the items described in question 5?

7. Items 3.4 and 19 of Form 41-101F2, Item 5 of Part A and Item 4 of Part B of Form 81-101F1, and Item 10 of Form 81-101F2 require disclosure in an investment fund's prospectus or annual information form (AIF), as applicable, regarding certain service providers to the fund. The CSA are considering adding the agent in respect of securities lending, repurchases and, if applicable, reverse repurchases to the list of service providers detailed in these Items. Another outcome of adding the agent to these Items would be that the agent's relationship to the manager would also be disclosed in the prospectus or AIF, so that investors can assess whether amounts are being paid to entities affiliated with the manager in connection with the investment fund's securities lending, repurchase or reverse repurchase activities. Is this disclosure useful? Should any additional details regarding the agent be provided in an investment fund's prospectus or AIF?

8. We understand that investment funds may seek different indemnities from their lending agent, which provide varying degrees of protection from losses that could arise from securities lending. Would disclosure of the indemnities obtained by an investment fund from its lending

agent in the AIF or prospectus of the investment fund be useful for investors in assessing the risks from securities lending?

9. Generally, investment funds do not file the agreements that they enter into with their lending agent on SEDAR. Currently, these agreements are not listed in the AIF under Item 16 of Form 81-101F2 or the prospectus under Item 31 of Form 41-101F2. Should these agreements be required to be included as material contracts and filed on SEDAR?

Annex D

Summary of Public Comments on Phase 2 Proposals for the Modernization Project

Part I – Background

Summary of Comments

On May 26, 2011, the Canadian Securities Administrators (CSA) published CSA Staff Notice 81-322 *Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project and Request for Comment on Phase 2 Proposals* to provide an update on the implementation of the Modernization of Investment Fund Product Regulation Project (the Modernization Project). In addition to providing an update on the status of finalizing Phase 1 of the Modernization Project, the CSA set out its proposed approach to Phase 2. The proposal included proceeding with Phase 2 of the Modernization Project in stages: first, developing a stand-alone operational rule for non-redeemable investment funds that would adopt certain core restrictions and operational requirements analogous to those in Regulation 81-102 (Regulation 81-102 or the Regulation) for mutual funds; and second, re-examining the investment restrictions applicable to open-end mutual funds and exchange-traded mutual funds under Part 2 of Regulation 81-102 to assess what, if any, changes should be made in recognition of market and product developments.

Supprimé: NI

Supprimé: NI

Supprimé: Instrument

Supprimé: NI

The CSA sought feedback from investors and industry stakeholders on the CSA's proposal to focus next on developing an operational rule for non-redeemable investment funds as part of a staged approach to proceeding with the Modernization Project. The comment period expired on July 25, 2011. We received submissions from 8 commenters, which are listed in Part III.

We have considered all comments received and have made some changes to the proposed approach in response to the comments. We wish to thank all those who took the time to comment. The comments we received, and our responses, are summarized below.

Part II - Comments on Phase 2 Proposals for the Modernization Project		
Question	**Comments**	**Responses**
1. Do you agree with our view that certain consistent, core investor protection requirements should apply equally to all types of publicly offered investment funds?	All of the commenters agreed that certain consistent rules and core investor protection requirements should apply equally to all publicly offered investment funds, including non-redeemable investment funds. Several commenters noted that the rules and restrictions identified in the notice (i.e., conflict of interest restrictions, securityholder and regulatory approval requirements and custodianship requirements) represent industry standards and best practices with which most managers of non-redeemable investment funds already comply. We were also told that investor protection rules and requirements should generally be harmonized unless there are policy reasons that support the limited application of certain protections. One commenter remarked that disclosure alone is an insufficient regulatory tool. One commenter added that retail investors are often unaware of the nuances between different	The CSA are committed to applying consistent rules and core investor protection requirements to all publicly offered investment funds. In addition to the core investor protection requirements identified in the notice, namely, conflict of interest provisions, securityholder and regulatory approval requirements, and custodianship requirements, we have reviewed each of the rules and restrictions in Regulation 81-102 to determine whether they are key operational requirements that provide a foundation for a base level of protection for investors. We considered whether there are investor protection issues that would support applying other requirements, such as investment restrictions, restrictions on the payment of organizational costs, and sales communications presentation requirements, equally to non-redeemable investment funds, or whether there are policy reasons to limit their application to mutual funds only. After reviewing the comments received and carrying out the above review, we propose

Supprimé: NI

	types of investment funds and their associated regulatory protections. This commenter expressed that it is essential that all available retail investment funds have basic investor protection requirements and that proposed regulatory requirements cover existing as well as future product types.	that generally, the same rules and restrictions should apply to all publicly offered investment funds except where distinctive features of conventional mutual funds or non-redeemable investment funds justify a difference in treatment. For example, the CSA think the different distribution models and redemption features may justify different restrictions on borrowing, illiquid assets, and requirements for the sale of investment fund securities.
	One commenter also suggested that in addition to making certain core investor protection requirements uniform across all publicly offered investment funds, there should be specific, stricter rules designed for certain types of funds (particularly complex and/or structured investment products) to ensure unsuitable products are not sold or made available to investors.	Along with our proposed amendments to Regulation 81-102 to apply operational requirements to non-redeemable investment funds, we are considering how to redesign the current regulatory regime under *Regulation 81-104 respecting Commodity Pools* (Regulation 81-104) so that it could apply to both mutual funds and non-redeemable investment funds that wish to use investment strategies that would go beyond the parameters of Regulation 81-102. The CSA have observed that many non-redeemable investment funds invest within the limits permitted for mutual funds in Regulation 81-102 (i.e., they use more conventional investment strategies), while others make extensive use of strategies not permitted by Regulation 81-102 (referred to as alternative investment strategies). We

Supprimé: NI

Supprimé: *National Instrument*

Mis en forme : Police :Italique

Mis en forme : Police :Italique

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

		think it is important to provide clarity for investors and the market by more effectively differentiating between conventional investment funds (whether they are structured as mutual funds or non-redeemable investment funds) and investment funds that use more complex investment strategies such as leveraged derivative strategies that are not permitted in Regulation 81-102 (referred to as alternative funds). In that regard, we are seeking feedback on elements of a regulatory framework for alternative funds that would be governed by Regulation 81-104, including disclosure requirements, naming conventions, and potential additional proficiency requirements for alternative funds. See Annex B.
	We were asked to ensure that we take into account the entire regulatory landscape, including the interrelationship of *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*, *Regulation 81-106 respecting Investment Fund Continuous Disclosure*, and *Regulation 81-107 respecting Independent Review Committee for Investment Funds*, when developing further rules for non-redeemable investment funds. One commenter noted that as non-redeemable investment funds are subject	Our proposed amendments aim to address arbitrage opportunities between different types of investment funds, which the CSA believe result from the differing regulatory regimes for mutual funds and non-redeemable investment funds. We continue to be of the view that all publicly offered investment funds should be treated more fairly and consistently, as both mutual funds and non-redeemable investment funds offer investors the benefits of pooled investing and portfolio management

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: National Instrument

Mis en forme : Police :Italique

Supprimé: *National Instrument*

Mis en forme : Police :Italique

Supprimé: *National Instrument*

Mis en forme : Police :Italique

	to these regulations, they already operate under securities regulations and industry standards that are more stringent than other investment options available to retail investors such as direct investments in stocks and bonds, segregated funds and linked notes, where equivalent regulations do not currently exist. This commenter urged us to consider that by introducing new regulations for non-redeemable investment funds, the CSA may unintentionally exacerbate, rather than reduce the potential for regulatory arbitrage. As such, any new regulations should also be considered in the larger context of all investment options available to retail investors. Another commenter added that we should be mindful of not simply mapping over rules currently applied to conventional mutual funds without considering the fundamental differences between these forms of investment funds. Considerations should include differences in redemption features, distribution models, leveragability, liquidity, and whether units are traded at net asset value (NAV).	services. It is outside the scope of this project to consider similar requirements for other types of investment products. We also think it would be beneficial for non-redeemable investment funds to be subject to key operational requirements as soon as possible. The CSA disagree that the proposed requirements for non-redeemable investment funds would result in investors being sold other types of investment products. We would expect dealers to continue to recommend non-redeemable investment funds where they present a suitable investment option for investors. The CSA agree that certain provisions should not apply equally to non-redeemable investment funds based on their unique features. We have considered the differences between conventional mutual funds and non-redeemable investment funds and proposed allowances to accommodate the unique features of non-redeemable investment funds. See the proposed amendments.
2. Do you agree with our approach to develop a stand-alone operational rule for non-redeemable investment	Two commenters expressed their support for developing a stand-alone operational rule for non-redeemable investment funds. These	After reviewing the comments received, the CSA have decided to amend Regulation 81-102 to include non-redeemable

Supprimé: instrument

Supprimé: ¶

Supprimé: NI

Supprimé: -

funds? If not, what approach would you propose? What are the advantages and disadvantages of this approach?	commenters believe that the advantages of this approach include: • focused regulation of non-redeemable investment funds; • clarity to fund managers as to what rules apply, since all regulation will be from a single source; • that a stand-alone rule will be the best mechanism for "borrowing" other important regulatory protections from Regulation 81-102. One commenter noted that a disadvantage of the stand-alone rule approach would be that it may result in a larger number of stand-alone rules for investment funds, rather than a single "trunk" of basic operational rules. This allows a greater potential for funds or products to slip through the cracks between each of the stand-alone rules and escape necessary regulation. One commenter recommended that any such stand-alone operational rule supersede all existing positions expressed by the CSA in notices or other publications regarding non-redeemable investment funds, for example OSC Staff Notice 81-711 *Closed-End Investment Fund Conversions to Open-End*	investment funds in applicable provisions of Regulation 81-102, rather than to create a stand-alone rule for non-redeemable investment funds. Under this approach, Regulation 81-102 will impose key operational requirements for all publicly offered investment funds, and where appropriate, will provide for exemptions for non-redeemable investment funds. Similar to the current structure of Regulation 81-104, the revised version of Regulation 81-104 we are contemplating will exempt alternative funds from certain provisions of Regulation 81-102, such as the limits on derivatives use and investing in physical commodities. We are also contemplating, however, that other requirements specific to alternative funds would apply, such as naming conventions and specific disclosure requirements. Please see Annex B. In the course of the CSA's review of the provisions in Regulation 81-102 that may be relevant to the operations of a non-redeemable investment fund, the CSA have observed that many of the requirements in the Regulation are base level protections, including certain investment restrictions, conflicts prohibitions, voting rights for

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

Supprimé: Instrument

	Mutual Funds. Three commenters, on the other hand, proposed that instead of having a stand-alone operational rule for non-redeemable investment funds, we introduce a universal operational rule that applies to all publicly offered investment funds including mutual funds and non-redeemable investment funds. Under this approach, the various categories of investment funds would be distinguished and the provisions that apply to each category would be clearly identified. Further, the universal operational rule could be supplemented with certain specific rules that only apply to non-redeemable investment funds. These commenters believe that the advantages of this approach include: • user-friendliness for industry participants such as lawyers, accountants and investment fund managers who advise or manage numerous types of investment funds; • consistency in the interpretation and application of the core investor protection requirements that will apply to all investment funds;	fundamental changes, and sales communications presentation requirements. It was also observed that the majority of non-redeemable investment funds already follow a substantial portion of Regulation 81-102, as many of the provisions reflect fund management best practices. Accordingly, the CSA are of the view that a single operational rule for all investment funds is a better approach to ensure the regulatory framework is more consistent, fair and functional for all types of investment funds. We accept the commenters' submissions regarding the advantages of a single operational rule. The CSA are seeking comment on whether to reconsider its current policy position of classifying an investment fund as a non-redeemable investment fund if it does not offer redemptions at NAV more than once a year. See Annex A. In light of new proposed requirements for non-redeemable investment funds, we will consider withdrawing OSC Staff Notice 81-711 *Closed-End Investment Fund Conversions to Open-End Mutual Funds*.

Supprimé: NI

Supprimé: -

	• simplification of the rule amendment process by reducing the need to make conforming changes across two or more rules; • automatic application of the rule to any new category of publicly offered investment fund which may develop in the future; • continuing the single rule approach for regulating all publicly offered investment funds, for example, taken in Regulation 81-106 and Regulation 31-103, which have been successful; and • the prevention of regulatory arbitrage by issuers. It was suggested by one commenter that although a single rule for all investment funds is preferable, if the CSA intend to limit the regulation of non-redeemable investment funds to the initial rules and restrictions identified in the notice and not extend it to other aspects of Regulation 81-102 in the future, then a separate stand-alone rule may be best. This commenter also suggested that the rule, whether stand-alone or universal, clarify our policy regarding when a fund is considered a	

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

	non-redeemable investment fund rather than a conventional open-end mutual fund.	
3. We seek feedback on the initial restrictions and operational requirements we have identified for non-redeemable investment funds. If you disagree, what restrictions and operational requirements would be appropriate for non-redeemable investment funds and why? If you think no requirements are needed, please explain why.	Generally, all commenters agreed that the initial restrictions and operational requirements we identified for non-redeemable investment funds are core investor protections that should be codified. Some commenters, however, identified several issues regarding the current requirements that apply to conventional mutual funds and requested that we focus on rationalizing these provisions before we extend them to non-redeemable investment funds. ***Conflict of Interest Provisions*** One commenter noted the importance of extending the self-dealing requirements to non-redeemable investment funds because while there is a mechanism under Regulation 81-107 for the independent review of conflict of interest matters by a fund's independent review committee (IRC), Regulation 81-107 is not sufficient in ensuring that non-redeemable investment fund managers will appropriately deal with conflicts, since the onus rests with the manager to identify the conflict in the first place and present it to the IRC for its review. Two commenters expressed significant concerns regarding the complexity of the	We propose to apply many of the core requirements in Regulation 81-102 to non-redeemable investment funds in their current form. The CSA will not at this time make any substantial amendments to the Regulation that would affect mutual funds. We will consider whether specific provisions in Regulation 81-102 should be amended in the next stage of the Modernization Project. Pursuant to the proposed amendments, Part 4 will apply to non-redeemable investment funds to prohibit the same self-dealing transactions and investments in related entities in which mutual funds are currently prohibited from engaging. We currently do not propose any substantial amendments to the conflicts of interest

Supprimé: NI

Supprimé: Instrument

Supprimé: NI

Supprimé: NI

Supprimé: NI

	current conflicts of interest regime, which includes the securities regulations of many provinces, Regulation 81-102, Regulation 81-107 and Regulation 31-103. This has resulted in a compliance maze where a single transaction often must consider multiple conflict of interest regulations (and on occasion, seek multiple discretionary exemptions) that ultimately address the same issue. These commenters urged us not to extend this complexity to non-redeemable investment funds, and encouraged us to instead rationalize the myriad of existing conflict of interest regulations for all investment funds. One commenter expressed support for extending the following restrictions to non-redeemable investment funds (subject to the provisions in Regulation 81-107): • purchases by funds of securities of related issuers (e.g., sections 111(2)(a) and 111(2)(c) of the *Securities Act* (Ontario)); • purchases by funds of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager (e.g., section 4.1(1) of Regulation 81-102). This same commenter suggested that it is not	requirements under Regulation 31-103 or Regulation 81-107. We will consider rationalizing the conflicts of interest regime in the context of future amendments to Regulation 81-107. Under the proposed amendments, a non-redeemable investment fund will be subject to all the prohibitions in Part 4, including the purchase of securities of certain related issuers and the purchase of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager. We propose to apply the fund-of-fund

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

	necessary to extend the following restrictions to non-redeemable investment funds: • fund-of-fund investing where a fund is held substantially by related funds (e.g., section 111(2)(b) of the *Securities Act* (Ontario)), since principles of fund-of-fund investing adopted by Regulation 81-102 are already observed by non-redeemable investment funds in accordance with industry practice, and non-redeemable investment funds are by definition prohibited from investing for the purpose of exercising control of an issuer; • purchases of an issuer in which a responsible person of the fund is a partner, director, or officer (e.g., section 4.1(2) of Regulation 81-102), since this prohibition is already in Regulation 31-103; and • trades of securities with related persons as principal (e.g., section 4.2 of Regulation 81-102), since this prohibition is already in Regulation 31-103. Another commenter expressed concerns with the governance structure, transparency and accountability of the IRC model and the role played by the IRC in dealing with conflict of interest matters. This commenter recommended	requirements in section 2.5 to non-redeemable investment funds investing in mutual funds so that conflict of interest requirements that may apply in the context of a fund-of-fund investment would not apply if the requirements of section 2.5 are complied with. Although certain prohibitions in Part 4 are also provided for in other regulations, the CSA are not considering the rationalization of the different conflicts of interest provisions at this time. As noted above, we will consider rationalizing the conflicts of interest regime in the context of future amendments to Regulation 81-107. The review of the IRC model under Regulation 81-107 is not within the scope of the Modernization Project.

Supprimé: NI

Supprimé: instrument

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

	that we reconsider the IRC model across the spectrum of publicly offered investment funds. This same commenter, however, generally agreed that Part 4 of Regulation 81-102 was a useful model in regulating conflicts of interest. In particular, this commenter believes that the liability and indemnification provisions in section 4.4 of Regulation 81-102 should be included in any proposed rule, as it is a basic investor protection measure to prevent placing investors at risk for the negligence of service providers. ***Securityholder and regulatory approval requirements*** Most commenters agreed that investors in non-redeemable investment funds should be entitled to vote on certain fundamental changes to the fund. Some further noted that current industry practice, as well as related corporate or listing requirements, already provide such entitlements. One commenter would support the fundamental changes that require unitholder approval to include a change to the fund's fundamental investment objective only if fund managers of non-redeemable investment funds retain their current flexibility to articulate the fund's investment objective in a manner that	As noted in the response above, section 4.4 will apply to non-redeemable investment funds pursuant to the proposed amendments. Pursuant to the proposed amendments, Part 5 will apply to non-redeemable investment funds so that investors of non-redeemable investment funds will have the same statutory rights as mutual fund investors to vote on fundamental changes to the fund. We propose to apply the securityholder approval requirement in Regulation 81-102 for a change of investment objective by the non-redeemable investment fund. Form 41-101F2 currently requires a non-redeemable investment fund to disclose in its investment objective the type or types of

Supprimé: NI

Supprimé: NI

Supprimé: Part

Supprimé: ¶

Supprimé: NI

Supprimé: -

	the manager considers most suitable. In particular, this commenter does not think the requirement that conventional mutual funds disclose in their investment objectives the types of securities or key investment strategies the fund intends to invest in or utilize should be extended to non-redeemable investment funds.	securities the investment fund will primarily invest in, as well as any investment strategy that is an essential aspect of the investment fund. This requirement is similar to the requirement for mutual funds in Form 81-101F1. We do not propose to change these requirements, as we think all investment funds should articulate their investment objectives with the same degree of specificity.
	One commenter remarked that Part 5 of Regulation 81-102 is an ideal model to adopt for non-redeemable investment funds. This commenter believes that voting rights for fund investors are key elements of investor protection and provide a check and balance on fund governance for significant transactions of the fund. In particular, this commenter would support a provision that requires fund managers rather than investors to bear the costs associated with reorganizing funds.	We agree that Part 5 should be adopted for non-redeemable investment funds. We propose to apply substantially all the securityholder approval requirements to non-redeemable investment funds other than in limited circumstances. We also propose to add an additional requirement that prior securityholder approval be obtained where there is a change in the nature of the fund, i.e., from a non-redeemable investment fund to a mutual fund, from a mutual fund to a non-redeemable investment fund, or from an investment fund to an issuer that is not an investment fund. The merger pre-approval requirements applicable to mutual funds, including that mutual funds not bear the costs of the reorganization, are proposed to also apply to reorganizations of non-redeemable investment funds. We also

Supprimé: NI

		propose to prohibit an investment fund from paying the costs of restructuring the fund. Given that reorganizations and restructurings permit managers to retain the fund's assets under management, these transactions are beneficial to managers and managers should accordingly bear the costs of these transactions.
	One commenter asked us to consider the realities of investment fund securityholder meetings and the current level of investor behaviour. Since most investors are passive, we were encouraged to consider less costly alternatives to holding securityholder meetings such as enhanced disclosure and advance notice of proposed changes, as well as the role played by the IRC.	We have proposed alternatives to the securityholder approval requirement, for example, obtaining IRC approval in cases where securityholders will not experience a significant impact from a fund merger, but we do not propose any amendments to the securityholder approval regime generally. We think it serves as an important check and balance on implementing fundamental changes to the fund.
	Another commenter noted, however, that even though many retail investors may not exercise their right to vote, it is significant that the voting rights outlined in Regulation 81-102 entitle them to receive a management information circular outlining the proposed change and that unitholders have an opportunity to vote.	The CSA agree with the importance of providing sufficient disclosure to investors of fundamental changes made to the investment fund. We do not propose to remove any such requirements.
	This same commenter expressed the view that non-redeemable investment funds should not	We do not propose any amendments to the regulatory approval requirements at this

Supprimé: NI

	be required to obtain regulatory approval of fundamental changes if securityholder approval had been obtained. This commenter believes that the additional cost and time required to obtain regulatory approval would not provide significant additional benefits to securityholders.	time.
	Another commenter, on the other hand, had concerns with the exemptions set out in Regulation 81-102 that permit significant reorganizations of funds without prior regulatory approval. This commenter believes that all fundamental transactions could benefit by being reviewed by the regulatory authorities.	See response above.
	Custodianship requirements Most commenters agreed that the segregation and security of investment fund assets is a paramount concern for investors and that these requirements should extend to all non-redeemable investment funds. It was also noted that it would make sense to move these requirements that are currently set out in a prospectus disclosure rule (Regulation 41-101) to an operational rule, as the requirements may have been overlooked by some industry participants who may expect Regulation 41-101 to relate mainly to prospectus content.	Pursuant to the proposed amendments, Part 6 of Regulation 81-102 will apply to non-redeemable investment funds. Part 14 of Regulation 41-101 will no longer apply to these funds.

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: -

	One commenter suggested that the current rule in Regulation 41-101 is too restrictive for non-redeemable investment funds because these funds often have investment mandates that require their assets to be deposited with a prime broker rather than a custodian. As well, the requirement that the custodian be a Canadian financial institution limits price competition between service providers. We were asked to amend these requirements so that non-redeemable investment funds may deposit assets with prime brokers in accordance with industry practice and permit funds to access a broader universe of available custodians.	The CSA do not propose any substantive amendments to the custodianship requirements at this time.
4. Are there other investor protection principles and/or requirements of Regulation 81-102 which the CSA should consider for non-redeemable investment funds at this time? If so, please explain.	One commenter believed that rules and requirements beyond those identified by the CSA were not necessary, while a few commenters proposed additional investor protection principles that should be considered. ***Sales Communications*** Three commenters believed the regulation of sales communications to be a key value in promoting investor confidence and investor protection and recommended that we consider	As noted above, the CSA believe there are key operational requirements in Regulation 81-102 in addition to the core protections identified in the notice that would provide a base level of protection for investors in non-redeemable investment funds. Imposing similar operational requirements would also level the playing field for all investment funds, providing a more consistent framework within which they can compete with each other. We propose to apply Part 15 to non-redeemable investment fund sales communications. The CSA are of the view that the sales communications requirements

Supprimé: ¶
Supprimé: NI
Supprimé: NI
Supprimé: NI

	adopting an equivalent to Part 15 of Regulation 81-102 that applies to non-redeemable investment funds. These provisions would provide certainty as to what type of disclosure is permissible and would ensure that marketing materials prepared for non-redeemable investment funds contain relevant information and do not include misleading or unsubstantiated claims. One commenter remarked, however, that these restrictions should not prevent non-redeemable investment funds from providing meaningful disclosure regarding new investment strategies or products which do not have a proven history or track record, provided that there is legitimate evidentiary support for such disclosure. ***Redemption of Securities of a Mutual Fund*** One commenter recommended that we adopt a requirement for non-redeemable investment funds to provide greater transparency to investors regarding the calculation of proceeds payable upon redemption of investment fund securities, particularly for investment funds that pay redemption proceeds that are less than the NAV per unit of the fund.	provide guidelines for investment funds to ensure that disclosure is relevant, consistent, and not misleading. The sales communication presentation requirements also ensure that disclosure of certain information such as performance data is standardized so that investors can make meaningful comparisons among similar investment funds. The requirements of Part 15 do not specifically prohibit disclosure regarding new investment strategies or products which do not have a proven history or track record. However, similar to mutual funds, we propose that sales communications for non-redeemable investment funds that present performance data present performance data based on actual historical performance, and not on hypothetical or back-tested data. We propose to make a consequential amendment to Form 41-101F2 that requires a non-redeemable investment fund to disclose in its prospectus the amount, or the maximum amount or percentage that may be deducted from the net asset value per security, if the proceeds payable upon redemption of a fund's securities are based

Supprimé: NI

		on the NAV per security. See proposed amendments to Form 41-101F2.
	This commenter also suggested that we adopt rules similar to Part 10 of Regulation 81-102 that require funds to have adequate procedures for processing redemption requests in a fair and timely manner and to suspend redemptions only when it is commercially reasonable to do so. This commenter added that most non-redeemable investment funds already comply with these provisions since they reflect industry best practices.	We also propose to apply certain provisions in Part 10 to ensure fair and timely administration of redemption requests and to limit when a non-redeemable investment fund may suspend redemptions. Similar to mutual funds, non-redeemable investment funds will be required to mail a notice to securityholders annually, reminding investors of their redemption rights and how they may be exercised. See proposed amendments to Part 10.
	Another commenter urged us to address the gradual trend within the investment fund industry to make redemption options less and less attractive to investors of non-redeemable investment funds, especially because these investors already face thin markets for selling their units. This commenter suggested that where a redemption feature is part of a non-redeemable investment fund, we limit the allowable fraction of NAV at which non-redeemable investment funds may redeem units to no less than 95% of NAV.	We do not propose any requirements relating to the amount of redemption proceeds at this time. As mentioned above, we are requiring a non-redeemable investment fund to disclose in its prospectus the maximum amount of any costs or other fees that may be deducted from the net asset value per security when securities are redeemed, so that the amount received by an investor will be clarified.
	Disclosure requirements A few commenters expressed support for the adoption of point-of-sale delivery and	The adoption of a point-of-sale disclosure regime for non-redeemable investment

Supprimé: NI

Supprimé:

	disclosure requirements for non-redeemable investment funds. One commenter recommended that non-redeemable investment funds be required to provide plain language disclosure as to how proceeds will be utilized. ***Conversions*** One commenter requested that we consider adopting rules for the conversion of non-redeemable investment funds to open-end mutual funds.	funds is not within the scope of the Modernization Project. Non-redeemable investment funds are required under Form 41-101F2 to disclose the principal purposes for which the net proceeds will be used by the investment fund and to disclose their fundamental investment objectives and the strategies used to invest the money received from the public. The Form also requires that disclosure in the prospectus be understandable to readers and presented in an easy-to-read format, as well as comply with plain language principles. Under the proposed amendments, a non-redeemable investment fund will have to obtain securityholder approval before increasing the frequency of redemptions and converting into a mutual fund. If the fund manager proposes to merge the non-redeemable investment fund with a mutual fund such that securityholders of the non-redeemable investment fund become securityholders of the mutual fund, prior approval of the securityholders of the non-redeemable investment fund must be obtained, unless the merger meets specified criteria in proposed subsection 5.3(2) of Regulation 81-102. A non-redeemable

Supprimé: NI

		investment fund that has a built-in conversion feature that triggers regular redemptions based on NAV may be exempt from the securityholder approval requirement if it meets specified criteria, including prospectus disclosure of the event that will cause it to convert into a mutual fund. See proposed amendments to Part 5.
	Principles that should not be adopted for non-redeemable investment funds One commenter identified several provisions in Regulation 81-102 that would not be appropriate for non-redeemable investment funds due to their different investment strategies and distribution models: • seed capital requirements for establishing new mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of dealers pursuant to a "best efforts" agency agreement (Sections 3.1 and 3.2 of Regulation 81-102); • restrictions on incentive and performance fees paid to fund managers, since the ability to enter all sorts of fee arrangements may encourage innovation of non-redeemable investment funds, so long as clear disclosure is provided in their prospectuses	The CSA agree that the specific requirements identified under Parts 3, 9, and 12 would not be applicable for non-redeemable investment funds. The CSA disagree, however, that the provisions under Parts 7, 11 and 14 should not apply to non-redeemable investment funds. The CSA are of the view that the provisions in Part 7 represent a fair basis for the payment of incentive fees. Since the CSA propose to apply comparable investment restrictions to non-redeemable investment funds that use conventional investment strategies, we are of the view that similar rules should apply to the payment of incentive fees by non-redeemable investment funds. As noted above, the CSA propose that investment funds that use

Supprimé: NI

Supprimé: NI

	and continuous disclosure documents (Part 7 of Regulation 81-102); • rules regarding the sale of fund securities as they relate to the sale of mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of Investment Industry Regulatory Organization of Canada (IIROC) dealers who are already subject to rules governing the sales process (Part 9 of Regulation 81-102); • commingling of cash restrictions, since IIROC dealers generally distributing securities of non-redeemable investment funds are already subject to rules governing the commingling of cash (Part 11 of Regulation 81-102); • compliance reports other than in relation to compliance with redemption requirements, since Parts 9 and 11 are not applicable to non-redeemable investment funds (Part 12 of Regulation 81-102); and • record date requirements, since non-redeemable investment funds should have the flexibility to determine appropriate record dates for establishing the rights of	alternative investment strategies be regulated under an amended Regulation 81-104, which allows for a wider range of incentive fee arrangements. While the CSA recognize that dealers of non-redeemable investment funds will be exempt from the requirements in Part 11 because they are members of IIROC, the CSA note that the provisions in Part 11 also apply to service providers of funds who receive cash on behalf of the investment fund for investment or redemption purposes. As the requirements in Part 11 ensure that investor cash is appropriately segregated, we are of the view that there is no policy rationale to support applying the requirements to service providers of mutual funds, but not to service providers of non-redeemable investment funds. See proposed amendments to Part 11. The CSA are of the view that the record date requirements in Part 14 should apply to non-redeemable investment funds on a similar basis as mutual funds, as there is no policy rationale to support different treatment. Currently, the record date requirements only apply to conventional mutual funds and not to exchange-traded mutual funds because exchanges impose

Supprimé: Part
Supprimé: NI
Supprimé: NI
Supprimé: -
Supprimé: NI
Supprimé: -
Supprimé: NI
Supprimé: NI

	securityholders to receive distributions, provided that the process for making these determinations is clearly disclosed in their prospectuses and continuous disclosure documents (Part 14 of Regulation 81-102).	rules on listed issuers in respect of setting record dates. Similarly, we propose to provide an exemption for non-redeemable investment funds that list their securities on an exchange. See proposed amendments to Part 14.
5. In addition to the initial requirements the CSA has identified for non-redeemable investment funds, we are considering the possibility of imposing certain investment restrictions, similar to those set out under Part 2 of Regulation 81-102. Please identify those core investment restrictions that, in your view, should apply to these funds and explain why. If you think no investment restrictions are needed, please explain why.	Most commenters generally agreed that investment restrictions similar to Part 2 of Regulation 81-102 should not be adopted for non-redeemable investment funds because the flexibility to implement alternative investment strategies in order to provide investors with exposure to different asset classes and innovative techniques is the primary distinction between conventional mutual funds and non-redeemable investment funds. These commenters feel that this distinction is beneficial to investors and should not be collapsed. Some commenters stressed that the liquidity and diversification requirements imposed on public mutual funds should not also apply to non-redeemable investment funds. This is because investors of non-redeemable investment funds generally have access to daily liquidity by trading their securities over a stock exchange and receive sufficient information regarding the NAV of the fund through various forms of disclosure. Further, requiring	The CSA are of the view that a number of the investment restrictions in Part 2 are core investment restrictions that aim to promote prudent management (for example, limiting counterparty risks under derivatives contracts) or define the fundamental characteristics of investment funds (for example, the control restrictions in section 2.2). We are also of the view that investment restrictions should apply in order to: (i) clarify the types of investments or investment strategies that the CSA do not view to be consistent with the passive investment nature of an investment fund; and (ii) more clearly delineate the types of investment strategies the fund is engaging in. However, we recognize that certain of the investment restrictions in Part 2 of Regulation 81-102 could be modified because of the differences in offering

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

	diversification to mitigate investment risks and volatility of the alternative investment strategies adopted by non-redeemable investment funds would be inconsistent with the purpose of investing in these funds. We were asked by one commenter to recognize the reliance placed by non-redeemable investment fund investors on the financial advisors and dealing representatives who sell these funds. These representatives are employed by full-service dealers that are members of the IIROC, and must satisfy higher proficiency requirements in order to understand the features of such funds and recommend them in suitable circumstances. A few commenters suggested that the additional investment risks and volatility associated with the investment strategies of non-redeemable investment funds could be addressed through disclosure. For example, one commenter suggested that any point-of-sale documents distributed by a non-redeemable investment fund disclose how the investment strategies of the fund differ from the investment restrictions set out in Part 2 of Regulation 81-102. One commenter urged us to consider investment restrictions for non-redeemable	models, liquidity for securityholders, and distribution channels. For example, we seek comment on whether different issuer concentration limits and illiquid asset limits could apply for non-redeemable investment funds. See Annex A. We have observed that there is a wide spectrum of non-redeemable investment funds, ranging from non-redeemable investment funds that invest in a similar manner as conventional mutual funds within the restrictions of Regulation 81-102 and non-redeemable investment funds that engage in more complex investment strategies. Non-redeemable investment funds may currently operate with a wide range of investment strategies with potentially very different levels of risk and complexity, but are all sold through the same distribution channel and subject to the same disclosure requirements. The CSA think it is important that investors can readily differentiate between investment funds that use conventional investment strategies set out in Part 2 of Regulation 81-102 and alternative funds that use investment strategies and invest in asset classes that are not permitted in Regulation 81-102.

Supprimé:

Supprimé: NI

Supprimé: NI

Supprimé: -

Supprimé: NI

Supprimé: NI

	investment funds at the same time as any review of investment restrictions for open-end mutual funds. Specifically, any proposal to impose investment restrictions on non-redeemable investment funds should be deferred to Stage 2 of Phase 2 of the Modernization Project.	In order to continue to provide flexibility for non-redeemable investment funds to use alternative investment strategies, we are considering how to redesign Regulation 81-104 so that it will encompass both mutual funds and non-redeemable investment funds that wish to utilize alternative investment strategies. We agree that one way to address the additional investment risks and volatility associated with alternative investment strategies is through increased transparency. We are contemplating that a fund be permitted to have more flexibility in utilizing alternative investment strategies if it complies with the contemplated regulatory framework in Regulation 81-104, which would include enhanced disclosure requirements to help inform investors about the differences in investment restrictions and the potential for increased complexity and higher degrees of risk associated with investing in alternative funds. We also invite comment on the proficiency requirements for the sale of alternative fund securities. In the next stage of the Modernization Project, the CSA plan to review the investment restrictions in Part 2 for mutual

Supprimé: NI
Supprimé: -
Supprimé: ¶
Supprimé: NI
Supprimé: -

		funds.
	One commenter proposed that investment restrictions for non-redeemable investment funds be limited to the investment restrictions set out in sections 2.12 to 2.17 of Part 2 of Regulation 81-102. These requirements on securities lending, repurchase and reverse repurchase transactions, in particular requirements regarding documentation, supervision, controls and records, reflect industry best practices and would not be unduly restrictive on the transactions.	We propose to apply sections 2.12 to 2.17 to non-redeemable investment funds.
	Another commenter recommended that we impose an anti-tiering provision on non-redeemable investment funds. This commenter expressed concerns regarding the potential tiering of fees that could result from fund-of-fund arrangements, as well as the replacement of one fund manager's judgment with another, which does not provide any additional benefit to the investor. This commenter, however, would exclude money market funds, index participation units or other static, low-fee funds from such anti-tiering provision.	The CSA propose that similar to mutual funds, non-redeemable investment funds investing in underlying mutual funds be prohibited from the duplication of fees in fund-of-fund structures.
	Another commenter noted that while some investment restrictions should apply to non-redeemable investment funds including scholarship plans, the current investment	The proposed amendments for non-redeemable investment funds do not affect scholarship plans. Amendments for scholarship plans are outside the scope of

Supprimé: NI

	restrictions that apply specifically to the subset of scholarship plans are far too restrictive and work to the detriment of plan holders.	the Modernization Project.
6. What do you foresee as the anticipated cost burdens in complying with the initial restrictions and operational requirements we are proposing for non-redeemable investment funds? Specifically, we request data from the investment fund industry and service providers on the anticipated costs of complying with the Phase 2 proposals.	One commenter noted that they would not be in a position to comment on the cost burden associated with the initial proposals until they have an opportunity to review the extent of changes under consideration. Several other commenters believed that the cost burden associated with the compliance of non-redeemable investment funds with the initial proposed restrictions and operational requirements would only be incremental and therefore not significant since these funds are already subject to the same requirements as conventional mutual funds under Regulation 81-106 and Regulation 81-107. One of these commenters also noted that any principal costs may be non-monetary, as additional regulations will hinder the ability of investors to access Canadian–based investment fund alternatives to conventional mutual funds.	The CSA have considered the anticipated costs and benefits of the proposed amendments to Regulation 81-102 to impose operational requirements on non-redeemable investment funds. We invite further comments on the costs associated with the proposed amendments. We think that the proposed amendments, together with a reformed Regulation 81-104 framework, will continue to permit fund managers to create alternatives to conventional mutual funds.
Other suggestions for Phase 2	We also received several suggestions from commenters regarding other issues to address in Phase 2 of the Modernization Project. These recommendations include:	We thank all commenters for suggestions on additional issues to consider in Phase 2 of the Modernization Project. We have reconsidered the exemption to the

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

	• modernization of the regulation of mortgage funds, as National Policy No. 29 has not been re-considered by the CSA since the coming into force of Regulation 81-102; • reconsideration of National Policy No. 15 and the regulation of scholarship plans, and how this regulation would fit into the regulation of non-redeemable investment funds; • greater access by mutual funds to investments in physical commodities, especially through commodity-based exchange-traded funds and derivatives, to allow investors to benefit from preservation of capital, greater performance in inflationary environments, and improved portfolio diversification; • review of derivatives requirements, as several requirements that apply to specified derivatives require greater guidance (for example, terms such as "a high degree of negative correlation" found in the definition of "hedge" in Regulation 81-102 lead to inconsistent interpretations in the industry); • reconsideration of the definition of "illiquid asset" in Regulation 81-102, as the current	rule preventing the reimbursement of organizational costs for exchange-traded mutual funds not in continuous distribution. The CSA propose to apply section 3.3 to all investment funds. We think imposing organizational costs on all fund managers could further align a manager's interest with those of investors and, at the same time, level the playing field for mutual fund and non-redeemable fund managers and discourage arbitrage opportunities. See proposed amendments to Part 3. We may consider some of the other suggested changes in the next stage of the Modernization Project. At this time, we will continue to consider requests for exemptive relief from Regulation 81-102 on a case-by-case basis. Some of the issues identified, including the regulation of scholarship plans, promotion and sales of investment funds, and exempt markets, are outside the scope of the Modernization Project.

Supprimé: NI

Supprimé: NI

Supprimé: NI

Supprimé: NI

	definition may not necessarily address a mutual fund's need to fund redemptions on demand (e.g., one commenter believes that the current definition captures securities that are in fact liquid, and amendments should be made so that the definition contemplates not only the type of security held, but also the size of each security position in a fund and trading volumes in the market); • increased flexibility for fund-of-fund structures, particularly involving multi-layered structures, Canadian pooled funds, and non-Canadian investment funds, to increase diversification opportunities and improve cost efficiency for investment funds; • reforms in the promotion and sales of investment funds; • reconsideration of exemptions to the rules preventing the reimbursement of organizational costs for all non-redeemable investment funds, as there may be price discrimination issues between initial and subsequent investors; and • implementation of a "Clients First Model",	

	a principle requiring industry participants to put the best interests of their clients first, which would require further tightening of rules related to conflicts of interest, advertising and marketing of investment funds, exempt markets and accredited investors, and the training of exempt market dealers.	
Other general comments	One commenter asked us to consider establishing an ongoing process for reviewing Regulation 81-102, soliciting industry comments and amending Regulation 81-102 on a more frequent basis to ensure that the regulatory framework evolves and keeps pace with product innovations, evolving capital markets and the needs of investors. A few commenters noted that the Modernization Project should not be allowed to delay other important initiatives of the CSA, including the final stages of implementing the point-of-sale disclosure project.	Noted. Noted.

Supprimé: NI

Supprimé: NI

Part III – List of commenters

Commenters

- Borden Ladner Gervais LLP
- Canadian Foundation for Advancement of Investor Rights (FAIR)
- Fasken Martineau DuMoulin LLP
- Fidelity Investments Canada ULC
- IGM Financial Inc.
- Kenmar & Associates
- Periscope Capital Inc.
- RESP Dealers Association of Canada