CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment

Modernization of Investment Fund Product Regulation – Alternative Funds

September 22, 2016

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing for a **90-day** comment period

- draft *Regulation to repeal Regulation 81-104 respecting Commodity Pools* (Regulation 81-104);
- draft *Regulation to amend Regulation 81-102 respecting Investment Funds* (Regulation 81-102);
- draft *Regulation to amend Regulation 81-101 respecting Mutual Fund Prospectus Disclosure* (Regulation 81-101;
- draft consequential amendments to:
    - *Regulation 81-107 respecting Independent Review Committee for Investment Funds* (Regulation 81-107);
    - *Regulation 41-101 respecting General Prospectus Requirements* (Regulation 41-101); and
    - *Regulation 81-106 respecting Investment Fund Continuous Disclosure* (Regulation 81-106);

(collectively, the Draft Amendments).

In addition, we are publishing draft changes to *Policy Statement to Regulation 81-102 respecting Investment Funds* and *Policy Statement to Regulation 81-107 respecting Independent Review Committee for Investment Funds*, and proposing to withdraw *Policy Statement to Regulation 81-104 respecting Commodity Pools*.

The Draft Amendments represent the final phase of the CSA's ongoing policy work to modernize investment fund product regulation (the Modernization Project) and is primarily aimed at the development of a more comprehensive regulatory framework for publicly offered mutual funds that wish to invest in asset classes or use investment strategies not otherwise permitted under Regulation 81-102.

Background

The Draft Amendments are part of the CSA's implementation of the Modernization Project. The mandate of the Modernization Project has been to review the parameters of product regulation that apply to publicly offered investment funds (both mutual funds and non-redeemable investment funds) and to consider whether our current regulatory approach sufficiently addresses product and market developments in the Canadian investment fund industry, and whether it continues to adequately protect investors. The Draft Amendments, if adopted, are expected to have a meaningful impact on publicly offered mutual funds that utilize alternative strategies or invest in alternative asset classes (alternative funds) and would also affect other types of mutual funds (namely conventional mutual funds and ETFs) as well as non-redeemable investment funds.

The Modernization Project has been carried out in phases. With Phase 1 and the first stage of Phase 2 now complete, the Draft Amendments represent the second and final stage of Phase 2 of the Modernization Project.

Phase 1

In Phase 1, the CSA focused primarily on publicly offered mutual funds, codifying 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 asset maturity restrictions and liquidity requirements for money market 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.

Phase 2 – First Stage

In the first stage of Phase 2, the CSA introduced core investment restrictions and fundamental operational requirements for non-redeemable investment funds. We also enhanced disclosure requirements regarding securities lending activities by investment funds to better highlight the costs, benefits and risks, and keep pace with developing global standards in the regulation of these activities. The Phase 2 amendments substantially came into force on September 22, 2014, except for certain transitional provisions that came into force on March 21, 2016.

Phase 2 – Second Stage – the Alternative Funds Proposal

The CSA first published an outline of a proposed a regulatory framework for alternative funds (the Alternative Funds Proposal), on March 27, 2013 as part of Phase 2 of the Modernization Project. In describing the Alternative Funds Proposal, the CSA did not publish draft regulation amendments. Instead, a series of questions were asked that focused on the broad parameters for such a regulatory framework (the Framework Consultation Questions).

The Alternative Funds Proposal dealt with issues such as naming conventions, proficiency standards for dealing representatives, and investment restrictions. We also proposed a number of areas where alternative investment funds could be permitted to use investment strategies or

invest in asset classes not specifically permitted under Regulation 81-102 for mutual funds and non-redeemable investment funds, subject to certain upper limits.

On June 25, 2013, we published CSA Staff Notice 11-324 *Extension of Comment Period* (CSA Staff Notice 11-324), which advised that the CSA had decided to consider the Alternative Funds Proposal at a later date, in conjunction with certain investment restrictions for non-redeemable investment funds that we considered to be interrelated with the Alternative Funds Proposal (the Interrelated Investment Restrictions) as part of the second stage of Phase 2.

On February 12, 2015, we published CSA Staff Notice 81-326 *Update on an Alternative Funds Framework for Investment Funds*, where we briefly described some of the feedback we received in connection with the Framework Consultation Questions.

Summary of Draft Amendments

Since Regulation 81-104 first came into force, the range of investment fund products and strategies in the marketplace has expanded significantly, both in Canada and in other jurisdictions. The Draft Amendments reflect the CSA's efforts to modernize the existing commodity pools regime by making the regulatory framework in Canada more effective and relevant to help facilitate more alternative and innovative strategies while at the same time maintaining restrictions that we believe to be appropriate for products that can be sold to retail investors.

The Draft Amendments, while focused on alternative funds, also include provisions that will impact other types of mutual funds, as well as non-redeemable investment funds through the Interrelated Investment Restrictions. The Draft Amendments seek to move most of the regulatory framework currently applicable to commodity pools under Regulation 81-104 into Regulation 81-102 and rename these funds as "alternative funds". They also seek to codify existing exemptive relief frequently granted to mutual funds, and to include additional changes arising from the feedback received on the proposals set out in the Framework Consultation Questions.

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

(i) Repeal of Regulation 81-104

As noted above, the CSA are proposing that the operational framework and investment restrictions applicable to alternative funds be contained within Regulation 81-102 rather than spread between separate regulations, as is currently the case for commodity pools with Regulation 81-102 and Regulation 81-104. This change would necessitate the repeal of Regulation 81-104, and the subsequent adoption of any applicable provisions into Regulation 81-102.

This proposal is consistent with the work done in the first stage of Phase 2 of the Modernization Project to integrate non-redeemable investment funds into the Regulation 81-102 regulatory

framework, and fulfills the goal of transforming Regulation 81-102 into the foundational operational regulation for all investment funds.

(ii) Definition of "Alternative Fund"

The CSA are proposing to replace the term "commodity pool" that exists in Regulation 81-104 with "alternative fund", a new term in Regulation 81-102 that we think will better describe the types of investment objectives and strategies that characterize these types of funds.

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 proposing a similar approach to the term "alternative fund" in Regulation 81-102, by defining it as a mutual fund that has adopted fundamental investment objectives that permit the mutual fund to invest in asset classes or adopt investment strategies that are otherwise prohibited, but for prescribed exemptions from the investment restrictions in Part 2 of Regulation 81-102. This also reflects that the Draft Amendments would result in a more comprehensive range of alternative fund-specific provisions than is currently the case for commodity pools.

(iii) Investment Restrictions

Concentration Restrictions

To allow for greater flexibility to engage in alternative investment strategies, we are proposing to permit alternative funds to have a higher concentration restriction than the current limit applicable to conventional mutual funds and to commodity pools under Regulation 81-102. Specifically we are proposing to increase the limit from 10% of net asset value (NAV) to 20% of NAV for alternative funds. As part of the Interrelated Investment Restrictions, we also propose setting the same concentration limit for non-redeemable investment funds. Currently the concentration restriction does not apply to non-redeemable investment funds, but many existing non-redeemable investment funds have adopted a concentration restriction that requires them to limit their investment in an issuer to no more than 20% of NAV at the time of purchase.

The proposed higher concentration limit for alternative funds and non-redeemable investment funds ensures consistency in terms of regulatory approach for all investment funds, while also providing flexibility to offer investors access to alternative investment strategies.

Investments in Physical Commodities

For mutual funds that do not qualify as alternative funds, we are proposing to expand the scope of permitted investment in physical commodities. Currently, mutual funds (other than commodity pools which are exempt from these provisions) can invest up to 10% of their NAV in gold (including 'permitted gold certificates'), but are otherwise prohibited from investing directly, or indirectly through the use of specified derivatives, in physical commodities other than gold (the Commodity Restriction). Under the Draft Amendments, the scope of permitted investments under the Commodity Restriction would be expanded to allow mutual funds to:

- invest directly in silver, palladium and platinum, in addition to gold (including certificates representing these precious metals), and
- obtain indirect exposure to any physical commodity through the use of specified derivatives.

This new range of permitted investment in physical commodities would remain subject to a combined limit of 10% of the mutual fund's NAV at the time of purchase, consistent with the current Commodity Restriction. This proposed change reflects exemptive relief that has been regularly granted to mutual funds and recognizes that physical commodities represent an asset class that can be used effectively within a diversified investment portfolio. We are also proposing to add a "look through" test in which investments in underlying funds would be counted towards the overall limit, primarily to ensure that funds cannot indirectly exceed the proposed investment caps through fund of fund investing.

As part of this change, we also propose to add the new definitions "permitted precious metal" and "permitted precious metal certificate" to Regulation 81-102, to reflect the inclusion of silver, platinum and palladium within the scope of physical commodities that can be held directly by mutual funds, and to repeal the definition of "permitted gold certificate".

Under Regulation 81-104, commodity pools are exempt from the provisions in section 2.3 of Regulation 81-102 governing investment in physical commodities and we are proposing to maintain this exemption for alternative funds under Regulation 81-102. Non-redeemable investment funds are also exempt from these provisions and we are not proposing to change this.

Currently, there are mutual funds that have received exemptive relief from Regulation 81-102 to be "precious metals funds" (as currently defined in Regulation 81-104) because their fundamental investment objectives provide that they invest primarily in one or more precious metals. We are proposing to adopt this definition into Regulation 81-102. Under the Draft Amendments, mutual funds that fit this definition would be exempt from the 10% limit on investment in physical commodities in respect of their investment in permitted precious metals. This would not represent a change in how precious metals funds currently operate.

Illiquid Assets

We are proposing to introduce a limit on investing in illiquid assets for non-redeemable investment funds. Currently all mutual funds are not permitted to invest in illiquid assets if, after the purchase, more than 10% of the fund's NAV would be invested in illiquid assets; and all mutual funds are subject to a hard cap of 15% of NAV. However, non-redeemable investment funds are not subject to such a limit under our current regulations. The Draft Amendments introduce an investment limit in illiquid assets of 20% for non-redeemable investment funds, with a hard cap of 25% of NAV.

The proposed limit for investments in illiquid assets by non-redeemable investment funds reflects the fact that unlike mutual funds, non-redeemable investment funds generally do not offer regular redemptions based on NAV. Rather, most non-redeemable investment funds primarily offer liquidity through listing their securities on an exchange. However, a significant number of non-redeemable investment funds do offer some form of redemptions at a prices based on the fund's NAV once a year, as well as, in many cases monthly redemptions at a price tied to market price, and therefore we believe a restriction on illiquid assets is important in order for those funds to meet their redemption requirements as applicable. We are seeking comment on the proposed limit on illiquid asset investments for non-redeemable investment funds.

We are not proposing to increase the permitted level of investment in illiquid assets for alternative funds or for other mutual funds. However, we recognize that there may be cases where certain types of alternative funds may, in accordance with their investment objectives wish to hold a larger proportion of their portfolio in illiquid assets, and will often accordingly offer redemptions on a less frequent basis. We seek feedback on whether a higher illiquid asset limit may be appropriate in those cases, and how best to make that work within the existing framework.

In addition, we continue to stay abreast of the various initiatives on liquidity risk management for investment fund products at the international level and how this may impact our work on this stage of the Modernization Project.

Fund-of-Fund Structures

We are proposing to permit mutual funds (other than alternative funds) to invest up to 10% of their net assets in securities of alternative funds and non-redeemable investment funds, provided those underlying funds are subject to Regulation 81-102. This reflects a recognition that some access to these types of products can be beneficial to a mutual fund's strategies.

We are also proposing to permit mutual funds to invest up to 100% of their NAV in any other mutual fund (other than an alternative fund) that is subject to Regulation 81-102, rather than just those that file a simplified prospectus (SP) under Regulation 81-101. This change would codify existing exemptive relief and would have the effect of permitting a mutual fund to also invest up to 100% of its NAV in exchange-traded mutual funds, whereas currently, they are limited to investing only in conventional mutual funds that file an SP. We are also proposing to remove the restriction that a mutual fund must invest in another investment fund that is a reporting issuer in the same "local jurisdiction" as the top fund. This means that a mutual fund will be able to invest in another investment fund so long as it is a reporting issuer in at least one Canadian jurisdiction, and reflects the fact that investment fund regulation is substantially harmonized in the Canadian jurisdictions. We are not proposing changes to any other aspect of the fund-of-fund rules under Regulation 81-102 for mutual funds.

Currently commodity pools under Regulation 81-104 are subject to the same fund of fund investing restrictions that apply to "conventional" mutual funds. These restrictions act to prevent a commodity pool, for example, from investing in another commodity pool or in any other type of fund, unless it is a mutual fund that has filed an SP under Regulation 81-101. We are

proposing to permit alternative funds to invest up to 100% of their NAV in any other mutual fund (which includes other alternative funds) or in non-redeemable investment funds provided the other fund is subject to Regulation 81-102. The other provisions applicable to fund of fund investing by mutual funds would still apply.

Currently, non-redeemable investment funds can invest up to 100% of their NAV in other investment funds and we are not proposing to change this, or any of the other fund of fund provisions that apply to non-redeemable investment funds.

Borrowing

The CSA are proposing to permit alternative funds to borrow up to 50% of their NAV in order to help facilitate a wider array of investment strategies by alternative funds than may be possible under the current restrictions. We are also proposing that these provisions apply to non-redeemable investment funds.

In addition, we are proposing that borrowing for both alternative funds and non-redeemable investment funds be subject to the following requirements:

- funds may only borrow from entities that would qualify as an investment fund custodian under section 6.2 of Regulation 81-102, which essentially restricts borrowing to banks and trust companies in Canada (or their dealer affiliates);
- where the lender is an affiliate of the alternative fund's investment fund manager, approval of the fund's independent review committee (IRC) would be required under Regulation 81-107; and
- any borrowing agreements entered into under this section must be in accordance with normal industry practise and be on standard commercial terms for agreements of this nature.

We are also proposing to amend the IRC approval provisions in section 5.2 of Regulation 81-107 in order to codify the IRC approval requirement described above, in that Regulation.

Short Selling

The CSA are proposing to permit alternative funds to sell securities short beyond the current limits in Regulation 81-102 to provide these funds with more flexibility to use long/short strategies. In particular, we are proposing to increase the aggregate market value of all securities that may be sold short by an alternative fund to 50% of the NAV of the fund, which is an increase from the current limit of 20% of NAV for all mutual funds (including commodity pools). We note that a number of commodity pools have already been granted exemptive relief to increase the aggregate market value of securities permitted to be sold short, to 40% of the fund's NAV. We are also proposing to increase the aggregate market value of all securities of any issuer that may be sold short by an alternative fund to 10% of the NAV of the fund, calculated at the time of the short sale, which is an increase from the 5% limit currently applicable to mutual funds (including commodity pools).

In addition, we are proposing to exempt alternative funds from 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. This is to help facilitate the use of "long/short" strategies by alternative funds in Canada.

We are also proposing that the same short-selling provisions applicable to alternative funds also apply to non-redeemable investment funds as part of the Interrelated Investment Fund Restrictions.

Combined Limit on Cash Borrowing and Short Selling

We are proposing that the combined use of short-selling and cash borrowing by alternative funds and non-redeemable investment funds be subject to an overall limit of 50% of NAV. That is, under the Draft Amendments, an investment fund that is either a non-redeemable investment funds or an alternative fund would not permitted to borrow cash or sell securities short if after doing so, the aggregate value of its short-selling and cash borrowing exceeds 50% of the fund's NAV. We view short-selling as another form of borrowing, and therefore believe it should be subject to the same borrowing limit as cash borrowing.

Use of Derivatives

Dodd-Frank Relief

One of the changes we are proposing is to codify exemptive relief frequently granted to mutual funds in response to the enactment of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (and the rules promulgated thereunder) in the United States and similar legislation in Europe (the Dodd-Frank Relief). Under this legislation, certain types of swaps are required to be cleared through a clearing corporation that is registered with the applicable regulatory agency in the US or in Europe. This legislation is part of an international initiative to more tightly regulate over-the-counter (OTC) derivatives, in response to the 2007-2008 financial crisis.

The Dodd-Frank Relief consists of relief from the counterparty designated rating requirement of subsection 2.7(1) of Regulation 81-102, the counterparty exposure limits of subsection 2.7(4) of Regulation 81-102 and the custodian requirements of part 6 of Regulation 81-102. It is intended to facilitate the entering into of transactions for cleared derivatives under the infrastructure mandated by those legislative reforms.

In order to codify this exemption, we are proposing to create a new defined term "cleared specified derivative", which will refer to any specified derivative that is cleared through this mandated infrastructure.

In turn, we propose to provide an exemption for all investment funds from subsections 2.7(1) and 2.7(4) of Regulation 81-102 for exposure to "cleared specified derivatives" and to amend section 6.8 of Regulation 81-102 in order to provide a specific exemption from the general custodian requirement to permit a fund to deposit assets with a dealer as margin in respect of cleared specified derivatives transactions.

Counterparty Requirements

We are proposing to exempt alternative funds from subsection 2.7(1) of Regulation 81-102. Currently, commodity pools are exempt from paragraph 2.7(1)(a) pursuant to Regulation 81-104, but are still subject to the requirements in paragraphs (b) and (c). As a result of the proposed change, a fund would no longer be prohibited from entering into certain specified derivatives transactions where either the derivative itself, or the counterparty (or the counterparty's guarantor), does not have a "designated rating" as defined in Regulation 81-102. This change would permit alternative funds to engage in OTC derivatives transactions with a wider variety of international counterparties. Since the financial crisis of 2007-2008, fewer firms that have been able to attain a "designated rating", which in turn limits the number of available counterparties. Access to a larger variety of counterparties can provide benefits to alternative funds in terms of pricing or products. Non-redeemable investment funds are already exempt from this subsection and we are not proposing to change that exemption.

To counterbalance the proposed exemption from subsection 2.7(1) for alternative funds, we are proposing to eliminate the exemption for commodity pools from the counterparty exposure limits in subsections 2.7(4) and 2.7(5) currently available to commodity pools under Regulation 81-104, and to non-redeemable investment funds under Regulation 81-102 (the Counterparty Exposure Exemption). Under the Draft Amendments, both alternative funds and non-redeemable investment funds would, subject to the general exemption for cleared specified derivatives referred to above, be required to limit their mark-to-market exposure limit with any one counterparty to 10%.

Repealing the Counterparty Exposure Exemption is intended to reduce the credit risk to a single counterparty, particularly in connection with OTC derivatives. Where an alternative fund's exposure to a single 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.

Cover Requirements

We are proposing to maintain for alternative funds, the current exemption from sections 2.8 and 2.11 of Regulation 81-102 applicable to commodity pools under Regulation 81-104, to permit an alternative fund to use specified derivatives to create synthetic leveraged exposure. Non-redeemable investment funds would remain exempt from these provisions.

Leverage

Under the Draft Amendments, alternative funds and non-redeemable investment funds may achieve leverage through a number of ways, including cash borrowing, short selling and

specified derivatives transactions. They may also obtain exposure through investing in underlying funds that employ leverage. Although the provisions relating to these investment strategies may specify limits on their use individually, we are proposing to create a single limit on the total leveraged exposure of an alternative fund or non-redeemable investment fund may have through these various strategies. This limit will also be used for disclosure purposes.

We are proposing that the aggregate gross exposure by an alternative fund or a non-redeemable investment fund, through borrowing, short-selling or the use specified derivatives cannot exceed 3 times the fund's NAV.

Specifically, a fund would have to calculate

- the total amount of outstanding cash borrowed,
- the combined market value of securities it sells short, and
- the aggregate notional amount of its specified derivatives positions, including those used for hedging purposes.

This would be divided that by the fund's net assets to determine whether this exposure falls within the prescribed limit. Under the Draft Amendments, the total leverage limit would have to be met by alternative funds and non-redeemable investment funds on an ongoing daily basis, and not just at the time of entering into a transaction that creates leverage.

We note an absence of uniform standards for measuring leverage. Leverage can be measured in different ways and may require different assumptions. We chose this methodology primarily because it is a relatively simple calculation and relies primarily on objective criteria thereby providing a common comparative standard by which to measure a fund's leveraged exposure. However, we recognize that that there are other methods for measuring leverage in a fund, and keeping abreast of international developments in this regard[1].

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, considering a mutual fund's need to fund regular redemptions. We also seek feedback on the methodology proposed under the Draft Amendments for measuring leverage.

(iii) New Alternative Funds

Seed Capital and Organizational Costs

For alternative funds, the CSA are proposing changes to the seed capital and other start-up requirements currently applicable to commodity pools under Regulation 81-104. We are

[1] The Financial Stability Board has identified leverage within investment funds as an area for further analysis in its work to address structural vulnerabilities from asset management activities. See: Financial Stability Board, Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities – Consultation Document (22 June 2016), online: http://www.fsb.org/wp-content/uploads/FSB-Asset-Management-Consultative-Document.pdf

proposing that alternative funds comply with the same requirements applicable to other mutual funds under Part 3 of Regulation 81-102. The biggest change would be that the seed capital requirement for alternative funds would increase from $50,000 (the minimum seed capital requirement currently applicable to commodity pools) to $150,000. Furthermore, rather than the manager having to maintain a $50,000 investment in the fund (as currently required for commodity pools), the manager of an alternative fund may redeem the seed capital once the fund has raised at least $500,000 from outside investors. The proposed changes to the seed capital requirements are consistent with feedback received during CSA's consultations and with exemptive relief that has been granted to a number of existing commodity pools.

(iv) Proficiency

Currently, Part 4 of Regulation 81-104 requires a "mutual fund restricted individual" (as defined in Regulation 81-104)[2] who sells commodity pool securities to have qualifications that go beyond the minimum requirements to be registered as a dealing representative of a mutual fund dealer (the Proficiency Requirements). Specifically, 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. There are currently no additional requirements for individuals registered as dealing representatives of an investment dealer who are also members of the Investment Industry Regulatory Organization of Canada (IIROC).

Consistent with the approach taken with proficiency requirements for registrants generally, we are of the view that the Proficiency Requirements would be best addressed through the existing registrant regulatory regime as opposed to following the Regulation 81-104 approach of incorporating such requirements into an operational rule for investment funds. For example, subsection 3.4(1) of *Regulation 31-103 respecting Registrant Requirements, Exemptions and Ongoing Registrant Obligations* establishes a general proficiency principle for all registrants, which states "[a]n individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently[.]" In addition, the Proficiency Requirements are duplicative with similar requirements in existing MFDA rules and policies. As a result, we are not proposing to move the Proficiency Requirements into Regulation 81-102 as part of the Draft Amendments.

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 recognize that it will be appropriate for additional education, training and experience requirements to apply to individual mutual fund dealing representatives who sell alternative funds. On this basis, it is reasonable to consider whether, in order to satisfy the general proficiency principle that applies to all registrants, specific training would be necessary for an individual dealing representative to understand the structure, features, and risks of any alternative fund securities that he or she may

[2] This term is generally intended to refer to a person registered as a mutual fund dealer. In all jurisdictions in Canada except Quebec, mutual fund dealers are also members of the Mutual Fund Dealers Association of Canada (the MFDA).

recommend. From this perspective, we are engaging with the MFDA in order to determine the appropriate proficiency requirements for dealing representatives of mutual fund dealers trading in securities of Alternative Funds. This work will be parallel to our ongoing work with the Draft Amendments and we will ensure that it has been completed before the Draft Amendments would come into force. We also note the CSA's ongoing consultations with respect to the proposals to enhance the obligations of dealers and representatives generally, as outlined in CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Adviser, Dealers, and Representatives Towards Their Clients*, which will also inform our work in this regard.

(v) Disclosure

Form of Prospectus/Point of Sale

A key element of the CSA's proposal for a more robust framework for alternative funds is to also bring alternative funds into the prospectus regime that exists for other types of mutual funds.

Currently, under Regulation 81-101, all mutual funds, other than commodity pools and exchange listed mutual funds, are required to prepare an SP, annual information form (AIF) and Fund Facts, with the Fund Facts having to be delivered at or before the point of sale. We are proposing that alternative funds that are not listed on an exchange be subject to this disclosure regime.

All other types of mutual funds, including commodity pools and exchange listed mutual funds, as well as non-redeemable investment funds, are required to file a long form prospectus under Form 41-101F2 of Regulation 41-101, which is delivered under the standard prospectus delivery period of within 2 days of the trade.

The CSA are currently finalizing amendments to implement a summary disclosure document similar to the Fund Facts, called ETF Facts, that will be prepared in respect of mutual funds that are listed on an exchange. It is expected that these provisions will also be applicable to listed alternative funds.

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

In connection with this we are also proposing changes to the Fund Facts to provide additional disclosure requirements for alternative funds. These changes would consist of requiring text box disclosure that would clearly highlight how the alternative fund differs from other mutual funds in terms of its investment strategies and the assets it is permitted to invest in. It is anticipated that complementary changes will also be reflected in the ETF Facts form requirements once they come into effect.

We are also proposing consequential amendments to Form 41-101F2 to remove any references to commodity pools.

Financial Statement Disclosure

Currently, Part 8 of Regulation 81-104 requires commodity pools to include in their interim financial reports and annual financial statements disclosure regarding their actual use of leverage over the period referenced in the financial statements (the Leverage Disclosure Requirements). In connection with the repeal of Regulation 81-104, we are proposing to incorporate the Leverage Disclosure Requirements into Regulation 81-106, with the requirement that it apply to any investment fund that uses leverage, which would therefore apply this requirement to non-redeemable investment funds as well. We are also proposing that the Leverage Disclosure Requirement apply to disclosure in an investment fund's Management Report of Fund Performance. Regulation 81-106 is the Regulation that sets out the applicable continuous disclosure requirements for investment funds, so it was appropriate to propose that the Leverage Disclosure Requirements be moved to that Regulation.

(vi) Other Changes

Except as modified or repealed as referenced above, in connection with the repeal of Regulation 81-104, all the provisions in that regulation that currently apply to commodity pools, would be integrated into Regulation 81-102 and would apply to alternative funds.

(vii) Transition/Coming into Force

Subject to the nature of comments we receive, as well as any applicable regulatory requirements, we are proposing that if approved, the Draft Amendments would come into force approximately 3 months after the final publication date, and would immediately apply to any investment fund that files a preliminary prospectus after that date. This will also apply to funds that filed a preliminary prospectus before the coming into force date but have not yet filed a final prospectus as of that date.

We recognize that for existing funds, a longer transition period may be needed to make the necessary adjustments to their portfolio as well as to their compliance and operational systems. Accordingly, we are proposing that for existing funds, the Draft Amendments not apply for an additional 6 months after the coming into force date of the Draft Amendments, provided that the fund filed its final prospectus before the coming into force date. We are also proposing that the Fund Facts pre-sale delivery requirements for existing funds will not apply for an additional 6 months from the coming into force date of the Draft Amendments.

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 changes to Policy Statement 81-102 are expected to be adopted as part of policies in each of the CSA jurisdictions.

Alternatives Considered to the Draft Amendments

An alternative to the Draft Amendments would be to not implement any changes to regulatory regime governing commodity pools and maintaining the status quo.

Not proceeding with the Draft Amendments would restrict the potential growth of commodity pools/alternative funds by limiting their ability to get exposure to new asset classes or to adopt new strategies, particularly those used by so-called "liquid alt" funds, that are commonplace in other jurisdictions for investment fund products sold to retail investors. While some of these strategies may be riskier, many are also designed to mitigate market risk, take advantage of market inefficiencies or to help produce more consistent returns under various market conditions. Alternative investment strategies have historically only been available in Canada to accredited investors or other types of investors eligible to purchase securities without a prospectus. The Draft Amendments would enhance the offering of alternative funds and strategies by setting an appropriate regulatory framework in which these strategies may be used in funds sold by prospectus. We think that not proceeding with the Draft Amendments would stifle innovation in the marketplace to the detriment of both investors and the investment funds industry.

As well, the prospectus regime for commodity pools would continue to be out of step with regulatory developments impacting the prospectus regime for other types of mutual funds.

Not proceeding with the Draft Amendments in respect of the Interrelated Investment Restrictions would not be appropriate in view of both investor protection and fairness concerns, since this would permit some non-redeemable investment funds o potentially operate in a manner that is inconsistent with other investment funds. The Interrelated Investment Restrictions are intended to create a more consistent, fair and functional regulatory regime across the spectrum of publicly offered investment fund products.

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 would benefit investors and the capital markets by encouraging product innovation and permit Canadians to gain exposure to investment strategies that have been employed for retail fund products around the world, while still maintain the protections that recognize that these products are being sold to retail investors.

The CSA are of the view that the Draft Amendments would not create substantial costs for investment funds, their managers or securityholders. Many of the Draft Amendments codify exemptive relief routinely granted, or expand prevailing investment parameters and limits currently applicable to mutual funds and commodity pools.

While some of the Draft Amendments would impose restrictions on non-redeemable investment funds that are not currently in place, our review of non-redeemable investment funds from the earlier stages of this Phase of the Modernization Project indicated that a large majority of non-redeemable investment funds follow investment restrictions that are comparable to the proposed Interrelated Investment Restrictions. 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. As a result, these managers are already equipped to monitor compliance with any additional investment restrictions. Therefore, we do not believe that the proposed Interrelated Investment Restrictions would create substantial costs for non-redeemable investment funds.

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. Specific quantitative data in support of your views in this context would be particularly helpful.

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. While welcome comments on any aspect of the proposal, we have also identified specific issues for comment in Annex A 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 websites of each of the Autorité des marches financiers at www.lautorite.qc.ca, the Ontario Securities Commission at www.osc.gov.on.ca and the Alberta Securities Commission at www.albertasecurities.com. Therefore, you should not include personal information directly in comments to be published. It is important you state on whose behalf you are making the submissions.

Please submit your comments in writing on or before December 22, 2016. If you are not sending your comments by email, please send a CD containing the submissions in Microsoft Word format.

Please note that some CSA jurisdictions may also host roundtables to discuss the Draft Amendments and we encourage interested stakeholders to participate.

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
Financial and Consumers Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon
Superintendent of Securities, Nunavut

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

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The Secretary
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Questions

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Contents of Annexes

The text of the Draft Amendments is published with this Notice and is available on the websites of members of the CSA:

Annex A – Specific Questions of the CSA Relating to the Draft Amendments

Annex B – Summary of Public Comments and CSA Responses on the 2013 Alternative Funds Proposal.

Annex A

Specific Questions of the CSA relating to the Draft Amendments

Definition of "Alternative Fund"

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

Investment Restrictions

Asset Classes

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

Concentration

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

Illiquid Assets

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

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

6. We are also proposing to cap the amount of illiquid assets held by a non-redeemable investment fund, at 20% of NAV at the time of purchase, with a hard cap of 25% of NAV. We seek feedback on whether this limit is appropriate for most non-redeemable

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

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

Borrowing

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

Total Leverage Limit

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

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

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

Interrelated Investment Restrictions

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

Disclosure

Fund Facts Disclosure

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

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

Point of Sale

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

Transition

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

ANNEX B

SUMMARY OF PUBLIC COMMENTS AND CSA RESPONSES ON THE 2013 ALTERNATIVE FUNDS PROPOSAL AND THE INTERRELATED INVESTMENT RESTRICTIONS

Table of Contents	
PART	**TITLE**
Part I	**Background**
Part II	**Comments on proposed alternative fund framework**
Part III	**Comments on proposed interrelated investment restrictions**
Part IV	**List of commenters**

Part I – Background

Summary of Comments

On March 27, 2013, the Canadian Securities Administrators (CSA) published proposals relating to the second phase of the Modernization of Investment Fund Product Regulation Project (the Modernization Project). The proposals included amendments to *Regulation 81-102 respecting Mutual Funds* (Regulation 81-102), changes to *Policy Statement to Regulation 81-102 respecting Mutual funds* (Policy Statement 81-102), related consequential amendments, and proposals relating to *Regulation 81-104 respecting Commodity Pools* (Regulation 81-104) and securities lending, repurchases and reverse repurchases by investment funds (collectively, the Proposals). On June 25, 2013, the CSA published CSA Staff Notice 11-324 *Extension of Comment Period* (CSA Staff Notice 11-324) to extend the closing of the comment period on the Proposals from June 25, 2013 to August 23, 2013.

The Proposals included an outline of a more comprehensive regulatory framework for alternative funds (the Alternative Funds Proposals). The Alternative Funds Proposal aimed to (i) introduce core investment restrictions and operational requirements for publicly offered non-redeemable investment funds, other than scholarship plans, (ii) enhance the disclosure requirements relating to securities lending, repurchases and reverse repurchases by investment funds and (iii) create a more comprehensive alternative fund framework to be effected through amendments to Regulation 81-104 (the Alternative Funds Proposal).

On June 19, 2014, the CSA published final amendments that introduced core investment restrictions and operational requirements for non-redeemable investment funds and new disclosure requirements with respect to securities lending by all investment funds (the June 2014 Amendments), which substantially came into force on September 22, 2014, with the final transitional provisions coming into force in March of 2016.

As was described in CSA Staff Notice 11-324, the Alternative Funds Proposal were being considered in conjunction with certain of the investment restrictions included in the Proposals and separately from the June 2014 Amendments. As a result, the CSA did not summarize comments on the Alternative Funds Proposal or certain draft amendments regarding investments in physical commodities, borrowing cash, short selling and use of derivatives (the Interrelated Investment Restrictions) in the Summary of Public Comments And CSA Responses published with the June 2014 Amendments.

We have instead chosen to summarize the comments we received on the Alternative Funds Proposal and on the Interrelated Investment Restrictions in connection with the current Notice and Draft Amendments, in part to reflect that these earlier comments helped to inform our efforts in preparing the Draft Amendments for consideration.

We received submissions from 36 commenters in relation to the Alternative Funds Proposal and the Interrelated Investment Restrictions, which are listed in Part IV. We wish to thank all those who took the time to comment.

Part II - Comments on proposed alternative fund framework

Issue	Comments	Responses
General comments	Many commenters stated that in order to properly evaluate the CSA's proposals with respect to non-redeemable investment funds, the CSA would need to publish further detail regarding the Alternative Funds Proposals. Additionally, any reforms to the to the investment restrictions applicable to non-redeemable investment funds should be undertaken in connection with the development of the Alternative Funds	We acknowledge this concern and have published the Draft Amendments for comment. We welcome any specific feedback on the proposals contained therein.

	Proposals.	
	Several commenters agreed with the concept of an Alternative Funds Proposals and thought such a regulatory regime would create opportunities for alternative fund managers and increased investment options for retail investors.	We agree and acknowledge that is consistent with the intent behind the Draft Amendments.
	Two commenters expressed concern that the Alternative Funds Proposals would create barriers to entry for alternative funds and result in these funds being labeled as high risk.	We believe that the Draft Amendments will address this concern but welcome any specific feedback in this regard.
	One commenter is of the view the creation of a category of investment funds which are "alternative funds" and which allow alternative investment strategies which present, in general, much greater complexity and higher risk, should, at a minimum, only be permitted if clear labelling is required, in the name of the fund itself (and the category) which makes the complexity and higher risk of this category of funds abundantly clear to retail investors.	The Draft Amendments do include disclosure requirements that will highlight the differences between alternative funds and other more conventional mutual funds in terms of strategies and investments. The required risk disclosure will be consistent with that of any other type of investment fund. We are not proposing a naming convention for alternative funds under the Draft Amendments.
	Two commenters encouraged the CSA to adopt a purposive or principles based framework rather than a prescriptive approach to the Alternative Funds Proposals to allow Canadian investors access to as many different types of alternative funds as possible.	The Draft Amendments are intended to fit within the existing regulatory framework for investment funds and therefore the approach taken with regards to prescriptive vs principles-based is consistent with the present regulatory regime.
	One Commenter stated that it is important to harmonize regulation for products perceived by the public as belonging to the same category of risk and liquidity as mutual funds. This prevents regulatory arbitrage and	The existing regulatory framework provides specific provisions for different types of investment fund products such as conventional mutual funds, conventional mutual funds traded on an exchange,

	mis-selling. Although where products are different and satisfy different investor needs, the best way to differentiate products is to ensure that there is a clear articulated difference in their structure. Products should be clearly separated based on structural factors such as whether they are redeemable or exchange listed. This would better help investors than creating different investment restrictions on the same types of funds depending on whether they are conventional or alternative.	money market funds, non-redeemable investment funds or other specialized funds including scholarship plans, labour-sponsored investment funds, and commodity pools. The Draft Amendments are intended to fit within the current framework.
	One commenter recommended that the CSA consider similar reforms, such as risk labelling of products or banning certain product features sold to retail investors in order to adequately protect investors. While disclosure is a necessary aspect of securities regulation, it alone will not provide adequate protection to retail investors	We agree that disclosure alone will not provide adequate protection to investors. While the Draft Amendments do expand the range of investment strategies available to alternative funds, it also imposes what we consider reasonable restrictions to reflect that these funds that are distributed to the public. The Draft Amendments will also address matters concerns dealer proficiency and we welcome any feedback in this regard.
	One commenter stated that minor deviations from the investment restrictions in Regulation 81-102, should not necessitate a fund being regulated by the alternative funds regime. The commenter asked CSA to clarify that they are not intending to force mutual funds currently investing in reliance of relief from Regulation 81-102 to transition to the alterative fund regulatory regime.	We agree. The Draft Amendments include codification of exemptive relief that has been routinely granted to mutual funds, and this has been accounted for in considering the range of provisions applicable to alternative funds or non-redeemable investment funds vs mutual funds. As such, we do not believe that it will force mutual funds to become alternative funds, or otherwise create any overlap between the two types of funds. However, we welcome any feedback where this concern may be identified.

	One commenter stated that the CSA appears to have a presumption that alternative funds are more risky than conventional funds, but that this is not the case for all alternative funds.	We agree that this is not always the case and believe the Draft Amendments do not necessarily have this presumption, but welcome any feedback in this regard.
Definition of Alternative Fund	A commenter expressed concerned that the use of the term alternative fund could be interpreted to mean these funds are high risk or volatile and that it may lead to confusion or preclude privately offered funds from utilizing the term alternative in their names.	We understand the concern. Under the Draft Amendments, the term "alternative fund" will be used for descriptive purposes to reflect that these funds are permitted to engage in certain strategies or invest in asset classes that are not permitted for more conventional mutual funds. We are not proposing any mandatory naming conventions or other labelling requirements. We are also proposing to remove the warning label language currently applicable to commodity pools under Form 41-101F2 because we recognize that not all alternative funds or strategies are inherently riskier than a conventional mutual fund. However, we are seeking feedback as to whether we should consider a different defined term to describe these types of funds.
	One commenter through a term based on the structure of a product would better assist investors.	Under the Draft Amendments, the term "alternative fund" will only be applied to mutual funds, and reflects that they can engage in strategies not necessarily available to more conventional mutual funds.
	Another commenter suggested that such funds be called "Risk-Magnified Funds", "Higher-Risk Funds" or some other term that sets out clearly that such funds	We did not propose a naming convention under the Draft Amendments, The Propose Amendments provide tailored disclose for Alternative Funds that will

	carry increased risks, as compared to conventional non-redeemable and mutual funds.	highlight how alternative fund differs from other conventional mutual funds in terms of the investment strategies and asset classes it is permitted to invest in.
	Two commenters believed the term alternative fund provided an appropriate description of the types of investment funds that should be captured by Regulation 81-104.	We agree this term will better describe the types of investment objectives and strategies that characterize these types of funds.
	A commenter felt that fixed portfolio ETFs (as defined in Regulation 81-102) should not automatically be considered alternative funds.	Fixed portfolio ETFs will not automatically be considered alternative fund under the Draft Amendments. We do note however, that this term is being replaced by the term "fixed portfolio investment fund", but this change will not impact whether or not these funds are considered alternative funds.
Concentration restrictions	One commenter stated the imposition of restrictions on selected aspects of investment fund strategies may impair these strategies without achieving the objective of increased investor protection. However the commenter supported the use of balanced restrictions that will enhance investor protection while permitting funds sufficient latitude to effectively execute their investment strategies.	We believe the Draft Amendments provide a good balance between investor protection and an effective framework for alternative funds offered to the public.
	Several commenters felt there is no need for a concentration restriction applicable to alternative funds.	We do not agree that there should be no concentration limits. Under the Draft Amendments, alternative funds will be considered to be mutual funds, a defining feature of which is the ability to redeem securities at

		their net asset value. Excessive concentration of a mutual fund's portfolio in a single issuer can impact a fund's ability to meet regular redemption requests.
	A few commenters suggested that an appropriate concentration restriction for alternative funds could be set using a threshold of 20% of total assets or net assets.	We are proposing to increase the concentration limits for alternative funds to 20% of NAV. We welcome any specific comments as to whether this is sufficient or not.
	Two commenters maintained that disclosure of the additional risks associated with a less diverse portfolio would be sufficient.	We believe the usual requirements regarding risk disclosure in an investment fund's prospectus will allow for sufficient disclosure of the risks connected with the concentration limits for alternative funds under the Draft Amendments.
	A commenter felt that fixed portfolio ETFs (as defined in Regulation 81-102), which may make concentrated investments in one or more issuers, should not automatically be considered alternative funds.	Under the Draft Amendments, fixed portfolio ETFs will not automatically be considered alternative funds. We also note that we are proposing to replace that term with the term "fixed portfolio investment fund", but that this change will not impact whether or not a fixed portfolio ETF that is a mutual fund will be considered an alternative fund.
	One commenter believed it would be appropriate for an alternative fund to be permitted to invest up to 30% of its net asset value in a single issuer and, perhaps as an additional control, to limit an alternative fund to investing no more than 50% of its net asset value, in aggregate, in holdings that exceed 10% of the fund's net asset value.	Under the Draft Amendments, the concentration limits applicable to an alternative fund will be 20% of net asset value, but we are not proposing any other specific concentration limits. We welcome feedback as to whether or not this is sufficient.

	One commenter advised that flow-through limited partnerships will often invest more than 10% of their net assets in securities of a single issuer.	We note that flow-through limited partnerships will not be alternative funds under the Draft Amendments as these types of funds are typically non-redeemable investment funds. The proposed higher concentration limit of 20 % will also apply to non-redeemable investment funds. That said we welcome any feedback regarding any specific hardships on certain types of funds that may result from the Draft Amendments.
Measurement of concentration where investments are leveraged	One commenter expressed the view that leverage cannot be examined in a vacuum and that liquidity of an investment fund's portfolio is more important than the fund's use of leverage from a risk management prospective. Another commenter stated the current leverage measurement requirements based on net asset value provide accurate information about the concentration of a fund's portfolio. A couple of commenters stated that if a concentration restriction where to be put in place, total notional exposure would be the appropriate measurement.	Thank you for the comment. We welcome feedback on the leverage provisions within the Draft Amendments. Under the Draft Amendments, the proposed methodology for measuring leverage will be based on NAV. The Draft Amendments contemplate using notional exposure to calculate leverage created by derivatives. The concentration provisions in Regulation 81-102 have always contemplated a look through test that considers indirect exposure through derivatives or investment in underlying funds and will continue to do so under the Draft Amendments.
Borrowing restrictions	A few commenters thought it is necessary that a borrowing limit should take into account whether the securities of the fund are redeemable or that funds should be required to match their redemption terms to the liquidity of their investments.	Under the Draft Amendments we decided on only one borrowing limit for alternative funds and non-redeemable investment funds, without consideration of redemption frequency. We are comfortable that the requirements will not impede a fund's ability to meet its redemptions, as borrowing will be limited to no

		more than 50% of a fund's NAV, when combined with any short-selling by the fund. The fund will still have to manage its portfolio in order to meet its redemption requirements consistent with Regulation 81-102. We welcome any specific feedback in this regard.
	One commenter believed that alternative funds should have a higher borrowing limit than conventional funds.	We agree and the Draft Amendments reflect this view.
	One commenter thought that borrowing from prime brokers would facilitate alternative fund investment strategies. The requirements prime brokers typically impose with respect to liquidity, leverage and capital will restrict the use of borrowing by funds.	Under the Draft Amendments, alternative funds would be permitted to borrow from an entity that would qualify as a custodian pursuant to section 6.2 of Regulation 81-102. This includes would include dealers that act as prime brokers in Canada. We welcome any specific feedback in this regard.
	A Commenter believed where an alternative fund invests outside of Canada it may be advantageous for the fund to borrow from a local lender.	The Draft Amendments do not contemplate permitting alternative funds to borrow from non-Canadian lenders. However, we welcome specific submissions on this issue.
	Two commenters stated alternative funds or non-redeemable funds should not be subject to any restriction on borrowing. The determination of the adequate leverage ratio for these funds should be left to the direction of fund managers.	We do not agree that there should be no limit on borrowing or leverage for alternative funds that can be sold to retail investors and have proposed limits on borrowing that we believe strike a reasonable balance between encouraging innovative strategies and limiting the risk to the funds from excessive leverage. We note that it is common in many international jurisdictions to impose borrowing limits on publicly distributed mutual funds.
Short selling restrictions	Several commenters thought Alternative funds should have increased flexibility to engage in short selling.	We agree. The Draft Amendments provide alternative funds with greater flexibility to engage in short selling. For example: • A larger portion of an alternative fund's portfolio

		can be sold short • A larger portion of a single issuer's securities can be sold short • We are proposing to remove the restrictions on the use of proceeds from short sales • We are removing the cash cover requirements (though short selling will fall within the overall leverage limits applicable to alternative funds).
	Many commenters expressed that the Regulation 81-102 investment restrictions that apply to short selling would impair the ability of alternative funds to utilize many common investment strategies. In particular, the cash cover requirements would prevent these funds from continuing to use common investment strategies.	Please see the response above.
	One commenter believed a blanket short selling limit of 40% of NAV may be acceptable where short selling for market hedging purposes (as defined by IIROC) is not included in the calculation of an alternatives fund's short selling for the purposes of compliance with the limit.	Please see the response above. The Draft Amendments do not contemplate an exemption for hedging transactions for the short selling limit.
	One commenter maintained that short selling of government bonds should be exempt from restrictions on short selling.	We are not proposing to exempt new type of securities from the short-selling restrictions at this time, but welcome any feedback on whether certain exemptions may be appropriate.
	One commenter stated that short selling is essential to alternative fund strategies.	We understand and believe the Draft Amendments reflects this.

	One commenter recommended the aggregate market value of securities of any one issuer that may be sold short by an alternative fund should be limited to 20% of the NAV of the fund and that the aggregate market value of all securities that may be sold short by an alternative fund should be limited to 100% of the NAV of the fund. A commenter thought allowing alternative funds to fully hedge out their long positions through equivalent short positions may also allow managers to tactically reduce portfolio volatility where they see potential downside risks to the market.	Please see above. We have not proposed that the short-selling provisions in the Draft Amendments go this far. We think the limits proposed therein are a reasonable place to start. We welcome any feedback on whether or not the short-selling provisions are sufficient. Please see above.
Leveraged daily tracking funds	A commenter stated that leveraged daily tracking alternative funds are highly volatile and clearly not appropriate for many investors. The commenter is of the view that many of the trades in these securities are done through discount brokerages where the proficiency of the registered representatives is not an issue, but the proficiency of the investor is a greater concern. The commenter believes that additional regulation may not be of assistance, but increased investor education is strongly recommended. Another commenter referred to disciplinary cases and cases before the Ombudsman for Banking Services and Investments where leveraged daily tracking funds have been sold to retail investors for whom they were not suitable.	Thank you for the comment. We agree that investor education is very important, particularly with respect to products with the potential for high volatility such as leverage daily tracking funds. A number of CSA members have made considerable efforts over the last years to improve investor education material on their websites In addition, a key element of the Draft Amendments is to also bring alternative funds into the prospectus regime that exists for other type of mutual funds, including the requirement to prepare a fund facts document. We are proposing that Alternative Funds provide additional disclosure in their fund facts documents. These changes will amount to required text box disclosure that will clearly highlight how the alternative fund differs from other conventional mutual funds in terms of investment strategies.

	One commenter believed that the existing regulatory regime mandates sufficient proficiency for the marketing and sale of alternative funds, including leveraged daily tracking funds.	Please see our responses below relating to proficiency standards for mutual fund restricted individuals dealing in Alternative Funds
Counterparty credit exposure	A few commenters thought it would not be appropriate to repeal the Counterparty Exposure Exemption from Regulation 81-104 and that maintaining the exemption would allow alternative funds to operate more efficiently. A number of commenters believed that imposing mandatory posting of collateral on a mark-to-market basis would be more appropriate. Requiring a counterparty to post collateral that is segregated from the other assets of the fund would mitigate risk. In addition, the CSA should consider imposing requirements as to the nature of the collateral that should be posted.	The Draft Amendments do include a repeal of the exemption for commodity pools from the counterparty exposure limit provisions of subsection 2.7(4) of Regulation 81-102 (the Counterparty Exposure Exemption), as well as introducing an exemption from the counterparty credit rating provisions in subsection 2.7(1) of Regulation 81-102 for alternative funds. This was seen as way to offer alternative funds more options in terms of counterparties to work with (as we understand that there are now fewer counterparties that would meet the "designated rating" threshold required under subsection 2.7(1) of Regulation 81-102, while at the same time mitigating counterparty risk by limiting a fund's exposure to any one counterparty. We welcome any specific feedback or commentary on other options that may more effectively help achieve the same goal.
	One commenter stated that counterparty risk is a significant issue for more than just the alternative funds sector. Rules on counterparty exposure should be consistent with other CSA rules on counterparties. Two commenters thought that central clearing requirements for derivative transactions would reduce the use of OTC derivatives by investment funds, but a restriction limiting unsecured exposure to any one	Under the Draft Amendments, the counterparty exposure limits in subsection 2.7(4) will apply to all investment funds, except in the case of specified derivatives that have been centrally cleared. The CSA currently has proposals out for comment for implementing a mandatory central clearing regime for certain types of derivatives transactions, similar to regimes implemented in other jurisdictions around the

	counterparty would mitigate risk.	world. The Draft Amendments contemplate an exemption from the counterparty credit limit provisions of subsection 2.7(1) of Regulation 81-102 and the counterparty exposure limits of subsection 2.7(4) of Regulation 81-102 for derivatives transactions that are executed through a central clearing house that is registered with the applicable regulatory agency.
	One commenter said an example of an operational efficiency that would likely not be available to alternative funds under a regime where the Counterparty Exposure Exemption was unavailable is alternative funds' use of clearing brokers. Many alternative funds use clearing brokers to help settle derivatives trades and net out exposures to what would otherwise be multiple counterparties. In this arrangement, the clearing broker acts as a counterparty to the fund and provides significant simplification with respect to negotiations with and monitoring of executing parties.	Please see above.
	A commenter thought it may also be difficult, given the relatively small size of the Canadian market and the challenges that Canadian alternative funds may face in accessing large numbers of counterparties, for alternative funds to observe a 10% counterparty exposure limit.	Please see above. As part of the Draft Amendments, we are proposing to loosen the requirements for alternative funds, to only engage with counterparties that have a "designated rating", with the intent that this will open up the range of counterparties available to transact with.
	One commenter did not believe that the Counterparty Exposure Exemption should be repealed because it is not clear that there is any risk from single counterparty exposure that needs to be mitigated.	Please see above. We welcome any specific feedback in this regard.

Total leverage limit	Two commenters stated the use of leverage by an investment fund does not necessarily mean that such a fund would be riskier than a fund that does not employ leverage.	While leverage itself may not necessarily make a fund riskier than one that does not use leverage, it does have to potential to magnify the potential loss in a way that an unlevered fund will not. As such, we believe that it is appropriate to set limits on the use of leverage by investment funds and to have those funds disclose their leverage, both of which are part of the Draft Amendments.
	One commenter believed the appropriate overall leverage limit for an alternative fund would depend on a number of factors, including the volatility of the fund's investments, risk parameters imposed by the manager, the liquidity of the fund's portfolio and how quickly the fund can de-lever. The Commenter supports the general principle of an overall leverage limit which accommodates as many different types of alternative funds as possible.	Under the Draft Amendments, we are proposing a single leverage limit for all alternative funds, to be calculated in the same way. We believe this will assist in investor in understanding and comparing leverage use by different funds.
	A commenter believed the calculation of the overall leverage of a fund should exclude hedging positions and positions in sovereign debt and associated currencies.	We have not proposed to allow for any exclusions in calculating total leverage under the Draft Amendments – this is consistent with how funds are currently expected to calculate their maximum use of leverage under Form 41-101F2. As well, hedging transactions do not necessarily fully offset the risk of the initial position – a full exclusion of any hedging transaction may obscure a fund's true leverage by assuming the hedged position creates an offset that may not actually be the case. However, we do welcome any additional feedback on these proposals.

	A few commenters suggested that the UCITS model for regulated alternative funds provides for more practical and meaningful ways of controlling risk than imposing an absolute limit on leverage or notional exposure. The CSA should consider liquidity, borrowing, VAR and diversification limits.	Thank for you the comment. We are aware of the UCITS model and note that Regulation 81-102 both currently and under the Draft Amendments, incorporates many similar elements. We are also seeking comments on the flexibility and convenience of using the gross notional exposure.
	One commenter felt it would be dangerous to monitor or regulate the risk of an alternative fund by limiting leverage or solely through a leverage limit.	We agree and are not proposing to do so under the Draft Amendments, which also include limits on the use of borrowing and short selling, independent of the overall leverage limit being proposed.
	A commenter suggested the CSA should focus on margin to equity ratios rather than leverage.	Thank you for the comment. The method we are proposing is intended to be a simple and consistent method to calculate total leverage across different types of alternative funds. The margin to equity ratio may be inconsistent across different funds and different periods. Required margins may vary from one derivative product to another as well as from one period to the next. We welcome any further comment in this regard.
	Another commenter agreed that a limit of 3:1 seems reasonable for alternative funds that are not mutual funds. For mutual funds, the total limit should be lower. The combination of illiquid assets and leverage may create further problems for mutual funds.	We agree and this is reflected in the Draft Amendments which contemplate a 3:1 leverage ratio for alternative funds and non-redeemable investment funds.
	One commenter believed exemptions from a total leverage limit should be considered on a case-by-case basis.	Considering leverage on a case-by-case basis is largely impractical from a regulation-making standpoint. However, we note that the Draft Amendments will not

		derogate from an issuer's ability to seek exemptive relief from any provision of Regulation 81-102.
	Another commenter proposed a total leverage limit of no more than 4:1 as an absolute limit and would suggest that 3:1 be set as the maximum at the time of investment, which would provide flexibility to account for market fluctuations.	We have proposed a hard limit of 3:1 leverage under the Draft Amendments as we want leverage to be monitored on a daily basis and not just at the time of investment. However, we welcome any feedback regarding whether or not this is unduly flexible for issuers.
	A few commenters expressed the view that a total leverage limit for funds that offer redemptions should be lower.	We believe the proposed 3:1 leverage limit is appropriate for alternative funds and non-redeemable investment fund and have not decided to set different limits based on whether a fund offers redemptions. This in part reflects the fact that the availability of redemptions is not much of a distinguishing feature between alternative funds (which under the Draft Amendments will be mutual funds) and non-redeemable investment funds, as a large proportion of them also offer redemptions at NAV on a yearly basis.
	One commenter felt alternative funds should be subject to a total leverage limit, whether it is 3x as proposed by the CSA or slightly higher, i.e. 4x. This will provide baseline protection for retail investors from highly levered products that are not appropriate even under the alternative fund framework.	We agree and this is reflected in the Draft Amendments.
	Another commenter stated that while the proposed level of absolute leverage at 3 to 1 is an appropriate starting point, it is important to ensure that overall levels of risk remain acceptable at the portfolio level.	Thank you for the comment. We note that Regulation 81-102, both currently and under the Draft Amendments, incorporates many provisions to address risks at the portfolio level. We welcome any feedback

		or commentary in this regard.
	One commenter believed Regulation 81-104 should not impose any restrictions on leverage for alternative investment funds. And that Regulation 81-104 should provide for a truly alternative regime that will permit for a range of investment strategies that are required in order to meet investors' needs.	We do not agree that alternative funds that can be sold to retail investors should have unrestricted leverage. We further note that this view is consistent with international regulation of similar products.
Measurement of leverage	A few commenters thought the current measurement of leverage as long position plus short positions over net asset value should be changed. Short positions entered into for hedging purposes should be subtracted from long positions.	Please see our response to a similar comment above. The Draft Amendments do not contemplate an exemption for hedging or netting transactions for the leverage calculations.
	One commenter believed the definition of leverage must be altered to allow alternative funds to employ meaningful risk mitigation techniques.	Please see our response above. Under the Draft Amendments, leverage can be created by cash borrowing, short selling and derivatives. Managers can employ risk mitigation techniques as long as they are permitted under Regulation 81-102, both currently and under the Draft Amendments.
	Another commenter felt disclosure should illustrate the effect of heightened volatility that is caused by leverage. This would illustrate the costs of leverage and provide a better sense of the potential risks. However, such a proposal would require developing reasonable assumptions regarding underling asset volatility and cost of leverage over time.	We thank you for your comment and welcome specific feedback in this regard.
	One commenter stated that it may be appropriate to measure leverage in conjunction with net exposure	Please see our response to similar comments above. In addition, we believe a limitation on net leverage may

	where strategies may look to achieve gross leverage levels in excess of 3 to 1. A limitation of net leverage (such as limiting net market exposures in a leveraged portfolio) where leverage exceeds 3x may be appropriate; however, it may also be appropriate to examine Value at Risk measures to limit overall portfolio risk in leveraged environments. Another commenter believed the issue of appropriate leverage measurement methods is best addressed by industry participants. And the concept or method chosen should be clearly formulated, expressed and disclosed and uniformly applicable.	be ineffective in accurately demonstrating a fund's level of leverage since the net exposure calculation does not distinguish leveraged positions from unleveraged ones. Furthermore, we note that although the value-at-risk is a quite comprehensive measure, it may not be a straightforward method of calculation and can be somewhat subjective in its elements. However, we welcome any specific feedback regarding appropriate methodologies for determining leverage and the overall risk of a fund. We welcome any feedback from industry participants in this regard.
Other investment restrictions	One Commenter did not believe a restriction limiting alternative funds to investing in other investment funds that are reporting issuers in the same jurisdictions as the alternative fund is reasonable. A commenter encouraged the CSA to permit Regulation 81-102 conventional mutual funds to invest up to 10% of their net assets in alternative funds. One commenter did not believe there should be restrictions on alternative funds comparing themselves to conventional mutual funds provided the comparisons are relevant, not misleading and that appropriate disclaimers are included.	Under the Draft Amendments, alternative funds will be permitted to invest in any investment fund subject to Regulation 81-102 without requiring that an underlying fund be a reporting issuer in the same jurisdiction as the top fund. This is being proposed under the Draft Amendments. Under the Draft Amendments, alternative funds will be defined by how their investment strategies are permitted to differ from those of more conventional mutual funds and will be required to highlight these differences in their disclosure documents.

	Another commenter felt all investment funds should be placed on a level playing field with respect to such matters as offering, operational and distribution requirements.	The Draft Amendments contemplate this. For example, we are proposing that non-listed alternative funds file a simplified prospectus and fund facts and offer point of sale delivery, and we are also proposing that new alternative funds abide by the same seed capital/start-up requirements as more conventional mutual funds.
	A commenter stated it is not practical to try to list every possible investment strategy that may be created or proposed in the future.	We note that currently, an investment fund is required to disclosure its fundamental investment objectives, including the primary strategies under which it will seek to achieve those objectives. The Draft Amendments will not amend these requirements.
	One commenter submitted that Regulation 81-104 should permit alternative funds to invest in funds that are reporting issuers in specified foreign jurisdictions, reporting issuers in at least one Canadian jurisdiction or offered under prospectus exemptions in Canada and have equivalent redemption/liquidity requirements as the top fund.	We have decided against codifying this approach as it is our preference to continue to consider investment in funds from a foreign jurisdiction or Canadian funds offered under prospectus exemptions matters on a case-by-case basis through exemptive relief. As noted above, we are proposing to simplify the fund of fund restrictions for to allow investment in underlying funds that are subject to Regulation 81-102, regardless of which jurisdiction an underlying fund may be a reporting issuer.
	Another commenter stated that the Alternative Funds Proposals should be as permissive as possible and they should not expressly permit or prohibit any strategy.	While the Draft Amendments do contemplate a wider variety of strategies or asset classes that will be available to alternative funds, we do not agree that alternative funds that will be distributed to the public should have no investment restrictions.

	Two commenters believed that if non-redeemable funds are restricted from holding non-insured mortgages, investment funds that are alternative funds should be permitted to hold them.	We have not proposed to change the current restrictions on investment funds investing in mortgages under Regulation 81-102 under the Draft Amendments. Please provide any specific feedback in this regard.
	A commenter expressed the belief that alternative funds should be exempted from paragraph 2.3(i) of Regulation 81-102 to permit them to invest up to 100% of their net asset value in loan syndications or loan participations (without regard to whether the fund would assume any responsibilities in administering the loan). These exemptions would enable alternative funds to provide retail investors with loan and mortgage fund solutions that currently are available only on a private placement basis.	We do not agree and have not proposed any changes to these restrictions under the Draft Amendments. We further take the view that this type of activity is not consistent with the notion of investment funds being passive investment vehicles.
	One commenter believed alternative funds should be permitted to invest up to 20% of their net asset value in illiquid assets.	We have not proposed to increase the illiquid asset limits for alternative funds as we believe the current limits for commodity pools are appropriate for alternative funds. We welcome any specific comments in this regard.
	One commenter felt that it is not in the best interest of investors in alternative funds to only permit "top" alternative funds to invest in underlying mutual funds that in turn hold no more than 10% of their net asset value in securities of other mutual funds. Such a restriction would prevent alternative funds from utilizing many types of efficient and effective multi-tier investment structures. Investors in alternative funds should have access to such multi-tier alternative fund structures, which can deliver the benefits of (1) greater	We do not agree and have not proposed any changes to the current restrictions on multi-tier fund of fund investment structures. These restrictions were originally put in place to reflect CSA concerns regarding among other things, complexity, transparency, and duplication of or hidden fees. These restrictions have been modified from time to time, usually on a case-by-case basis through exemptive relief to reflect multi-tier structures which in the CSA's view do not raise similar concerns. To the extent that

	portfolio diversification at a reduced cost relative to that which could otherwise be achieved were the top fund required to invest directly in securities held by the underlying funds; (2) more favourable pricing and transaction costs on portfolio trades, increased access to investments and better economies of scale that can be achieved when the top fund invests through underlying funds; and (3) overall reduced portfolio complexity and increased administrative ease, which results in efficiencies that can be passed on to investors in the top funds. The above-noted advantages outweigh regulatory concerns regarding the potential complexity of the structure and duplication of fees, which can be appropriately addressed through disclosure and restrictions on duplication of fund fees and costs. A commenter supported the CSA's proposal to maintain the exemptions in 2.3(d)-(g) and (h), 2.8 and 2.11 of Regulation 81-104 for alternative funds. One commenter felt Regulation 81-104 should not impose any further restrictions. Should provide for ample flexibility for strategies that are not provided for in Regulation 81-102.	there may be specific structures in which the efficiencies may outweigh the regulatory concerns, we remain of the view that these are best addressed through the exemptive relief process. Thank you for the comment. We are proposing to maintain these exemptions for alternative funds. The Draft Amendments aim at providing a reasonable balance between encouraging innovative strategies and investors protection.
On-going investment by sponsors	Two commenters did not believe there is a reasonable basis for creating a different seed capital requirement for alternative funds. Two commenters thought sponsors of an alternative fund should be able to withdraw their seed capital once the fund reaches a certain size.	We agree. Under the Draft Amendments, the seed capital requirements for alternatives will be the same as for other mutual funds. We agree. Under the Draft Amendments, alternative funds will be permitted to start withdrawing seed capital once the fund has raised $500,000 in capital from "outside" sources, which is consistent with the

	One commenter felt sponsors should not be required to maintain an investment in their fund. However, where a sponsor does so, the seed capital should be included in the sponsor's working capital calculation. One commenter did not think seed capital requirements should not apply to non-redeemable investment funds.	requirements for conventional mutual funds. Please see above. We are proposing to amend the seed capital requirements for alternative funds to be align with those of other mutual funds. We have not proposed to change the seed capital requirements applicable to non-redeemable investment funds under the Draft Amendments.
Proficiency standards for representatives dealing in Alternative Funds	Several commenters did not feel additional proficiency requirements are necessary for individuals dealing in alternative funds. Additional proficiency requirements would only limit the distribution channels available to alternative funds. Two commenters thought that IIROC registered representatives should not require additional proficiency requirements to sell alternative funds but that proficiency standards for mutual fund restricted representatives should be maintained. [8] One commenter stated that there are no existing courses or proficiency requirements for dealing representatives that would add value to the offering of alternatives funds. [9] One commenter encouraged the CSA to reconsider the existing proficiency requirements in Regulation 81-104 with the goal of determining whether these are appropriate or necessary.	Under the Draft Amendments, we are proposing to remove the proficiency requirements currently applicable to mutual fund restricted individuals that trade in securities of a commodity pool (the Proficiency Requirements) under Regulation 81-104 for alternative funds. This recognizes that a fund operational regulation is not the appropriate place for what is essentially a "know your product" provision and that some of provisions may be out of date, having not been updated since its initial implementation. We are of the view that these requirements would be best addressed directly through the registrant regulatory regime including through SRO's such as the Mutual Fund Dealers Association (MFDA), which are best placed to determine the appropriate proficiency standards for mutual fund dealer representatives. To that end we will be working with the MFDA to come to the best solution on this issue. We have not proposed any changes to the proficiency requirements for IIROC registrants. We welcome any specific feedback on the Proficiency

	One commenter thought it was necessary that individual representatives that sell alternative funds have a fiduciary duty to act in the best interests of their clients. Another commenter supported improved proficiency requirements for all registrants who sell investment funds, and, in particular, increased proficiency requirements for registrants selling alternative funds. A commenter felt the current mutual fund course does not sufficiently address the topic of alternative funds and that additional alternative funds content should be added to the current course or a separate alternative funds course should be created. One commenter stated that the proposal to impose additional proficiency requirements on individual dealing representatives who sell securities of alternative funds is fundamental to the success of the Alternative Funds Proposals. The commenter believes that many problems that have occurred with alternative investments could have been avoided where individual dealer representatives properly understood the risks of their products and effectively discharged their suitability obligations. The commenter suggested that the CSA should consider Chartered Financial Analyst, Chartered Investment Manager or Chartered Alternative Investment Analyst designations as proficiency standards for representatives dealing in alternative funds. One commenter suggested the CSA consider the	Requirements in light of the Draft Amendments.

	creation of individual registration categories for alternative fund dealing representative and associate alternative fund dealing representative. A commenter stated, with respect to non-redeemable investment funds in particular, the creation of additional proficiency requirements for the sale of alternative fund securities would represent a fundamental and potentially adverse change to the ongoing business and affairs of existing non-redeemable investment funds as well as the manufacture and distribution of non-redeemable investment funds in Canada.	
Naming convention for Alternative Funds	Most commenters who provided comments regarding the imposition of a naming convention for alternative funds objected to either the concept of a naming convention or to the proposed use of the term alternative fund. Many commenters objected to the proposed use the words alternative fund as part of the naming convention. These commenters felt such a term could result in alternative funds being labeled as high risk or volatile. Many commenters felt the term alternative fund would not necessarily identify for investors the nature of alternative funds or level of risk and complexity that is associated with these funds. Several commenters believed that improved disclosure was a better approach than a naming convention. These	Please note that we are not proposing a naming convention for alternative funds under the Draft Amendments. Please see above. Please see above. We agree, which is why the Draft Amendments include specific disclosure requirements for alternative fund prospectuses. We agree. Please see above. Among the provisions applicable to alternative fund disclosure in the Draft

	commenters believed it would be more useful for each fund to provide investors with meaningful and prominent disclosure of the fund's key investment objectives, strategies and risks in its disclosure documents, and for non-conventional funds to highlight for investors in a prominent manner the extent to which the fund's investment restrictions and strategies may differ from those used by conventional mutual funds.	Amendments will be a requirement for an alternative fund to disclosure how its investment strategies differ from what is permitted by a conventional mutual fund.
	Several commenters specifically stated that drawing a clear line between funds subject to either Regulation 81-102 or Regulation 81-104 may mislead investors into believing that all funds under one framework are the same and draw attention away from the wide variance among funds within each framework.	We note that this is the case today between mutual funds and commodity pools, but we welcome specific feedback on the Draft Amendments on this issue or concern.
	One commenter felt the imposition of a naming convention would be a highly effective tool and agreed with the use the words alternative fund.	While we have not proposed a naming convention that would mandate the use of the world “alternative fund” in a fund’s name, the term will be still be used for descriptive purposes in distinguishing an alternative fund from a conventional mutual fund.
	One commenter believed better labelling in the name of the investment fund of the heightened risk and complexity along with more robust regulation and enforcement of misleading advertising, coupled with a best interest standard, would go a long way to helping to protect investors. The commenter suggested that such funds be called "Risk-Magnified Funds", "Higher-Risk Funds" or some other term that sets out clearly that such funds carry increased risks, as compared to conventional non-redeemable investment funds and mutual funds.	As noted above, we have not proposed to institute a naming convention for alternative funds, though the term will be used for descriptive purposes. While we do not agree that alternative funds will in all cases be inherently riskier than all conventional funds, we welcome any comments regarding whether we should consider a different term to describe these funds than “alternative funds”.

	A commenter suggested investment products should have risk labeling and that the CSA should ban the sale of certain classes of types of product to retail investors.	We note that the regulatory framework for investment funds requires disclosure of applicable risk factors as well as requiring risk ratings for investment funds. As well, the applicable investment restrictions for investment funds that are distributed to the public necessarily restrict the types of products that can be sold to retail investors.
	One commenter stated that requiring existing funds to change their names to comply with a naming convention requirement would create unnecessary cost and confusion to investors.	Please see above. We have not proposed a naming convention for alternative funds.
	A couple of commenters believed it would be more helpful to differentiate products based on their structure and that descriptor based on the type of securities a fund may invest in or its investment strategies could be interpreted in various ways or be too restrictive to describe all possibilities.	Regulation 81-102 does differentiate funds based on their structure in some aspects (such as whether they are listed or not, or whether or not they are redeemable on a regular basis). We don't believe the Draft Amendments will necessarily change this.
	One commenter felt that to make a naming convention work, clear definitions of alternative and conventional funds would be necessary.	Please see above. We have not proposed a naming convention, though the term "alternative fund" is being defined in Regulation 81-102 as part of the Draft Amendments.
	A couple of commenters believed the term alternative fund is too generic or simplistic to include in a fund name.	Please see above.
	One commenter thought conventional mutual funds should adopt the more fulsome disclosure requirements of the long form prospectus and mutual funds should	We do not agree that mutual funds should adopt the long form prospectus. The simplified prospectus and fund facts document were designed to better assist

	not be able to bundle multiple funds into a single prospectus.	investors in understanding the product. Furthermore, as mutual funds are required to distribute the fund facts document in lieu of a simplified prospectus, we do not see any reason to prohibit the bundling of multiple funds into a single prospectus, which is administratively more efficient.
Monthly website disclosure	One commenter believed there should be no distinction in disclosure requirements for conventional and alternative funds. However the commenter supported the introduction of a requirement that all publicly offered investment funds disclose additional variables to understand the risk and performance of a fund, including the standard deviation of a fund. A couple of commenters did not believe publishing maximum and average daily leverage would provide meaningful information to investors, as leverage may not be as significant an indicator of risk as other factors. These commenters felt the proposed disclosure requirements are limited and may be taken out of context. One commenter felt these seemed like reasonable	We are not proposing specific website disclosure for alternative funds under the Draft Amendments. However, we will be mandating certain disclosure in a fund's financial statements regarding its experience with leverage. In addition, the fund facts document, which will be mandated for alternative funds, disclose adapted information in order to help investors understand a fund's risk and performance. Please see the response above. We note that the total leverage limit is not technically a risk indicator. Thank you for your comment.

	proposals and would not be too onerous on the part of the manager to implement. Another commenter agrees with the proposed disclosure requirements and thinks other risk metrics on a quarterly basis may be useful to investors. One commenter stated that disclosure of monthly performance data would be more meaningful and that the proposed disclosure may be misleading. In particular, the disclosure of maximum drawdown is in the absence of further information will not useful. The commenter suggested the CSA revisit general instruction 11 to Form 41-101F2 to allow for performance data over shorter periods of time.	Please provide any additional feedback on what risk metrics could be relevant for investors. We are not proposing to review performance data disclosure.
Transition to Alternative Funds Framework	Many Commenters believed existing funds should be grandfathered and not made to transition to the alternative funds framework. One commenter felt existing funds that are not offering securities to the public should be grandfathered. One commenter stated that if existing funds were made to comply with a new regulatory regime there would be considerable costs associated with changes to funds and their investment strategies. A commenter felt existing funds that are required to transition to the alternative funds framework should be permitted to provide written notice of their intention to transition into the alternative funds regime.	We are proposing a 6 month from the coming into force date transition period for existing funds to transition to the new requirements for alternative funds to the extent that they are impacted by them. However, we will expect any new funds filing a prospectus after the date the Draft Amendments come into force to comply with those requirements from the first day of operations. We welcome any feedback on whether or not this is an appropriate transition period for existing funds.

Other comments	One commenter stated that alternative funds should be permitted to utilize the Regulation 81-101 simplified prospectus and fund facts disclosure regime. Another commenter believed the CSA should move ahead with point of sale disclosure for all investment products including alternative funds. One commenter did not believe that an alternative fund should be required to disclose in its prospectus how its investment strategies differ from a conventional fund. Such disclosure is not relevant and potentially misleading. This emphasizes potential risk without allowing potential benefits to be disclosed.	We are proposing that alternative funds that are not listed on an exchange use the simplified prospectus and fund facts under the Draft Amendments. We are proposing that alternative funds that are not listed on an exchange be subject to the point of sale requirements under Regulation 81-101. We do not agree as it is these differences that will distinguish an alternative fund from a conventional mutual fund. Therefore we believe this disclosure is important and relevant.

Part III - Comments on proposed interrelated investment restrictions		
Issue	**Comments**	**Responses**
Borrowing (s. 2.6(a) to (c))	CSA to permit non-redeemable investments funds to borrow from lenders outside of Canada. A couple of commenters thought limiting non-redeemable investment funds to borrowing from Canadian financial institutions would significantly limit the sources of financing from non-redeemable investment funds. These commenters felt that non-redeemable investment funds may prefer to borrow from financial institutions that are not Canadian financial institutions because of potential for	Please see our responses above relating to borrowing by an alternative fund. Please note that we are also seeking feedback regarding any additional specific differences between alternative funds and non-redeemable investment funds that we should consider in respect of the proposed borrowing provisions.

	preferential rates, better terms, or a pre-existing relationship with the lender. A couple of commenters felt it would be appropriate to borrow from a foreign bank or other institution where a fund has an objective to benefit from investing in foreign markets which may be denominated in foreign currencies and desires leverage denominated in the same currencies to hedge currency exposure. Many commenters did not believe that restricting the use of leverage by non-redeemable investment funds is appropriate or necessary to ensure that investors are protected. These commenters encouraged the CSA to reconsider the proposed restriction. A number of commenters believed enhanced disclosure would be a better solution than a restriction on borrowing. A number of commenters felt the current borrowing practices of non-redeemable investment funds may not be the most appropriate basis on which to set a borrowing limit. Although there are currently a number of non-redeemable investment funds that would fit within the CSA's proposed restriction on borrowing, the restriction on borrowing may cause some funds to move to the alternative funds regime, which may not be the intention of the CSA. One commenter saw no evidence justifying a conclusion that additional monitoring and controls exist or otherwise it would be in the best interests of	

	investors to be exposed only to Canadian financial institutions. One commenter suggested limiting the list of lenders to Canadian and foreign regulated banks, regulated insurance companies and regulated investment dealers and their wholly-owned subsidiaries. Three commenters expressed concern a requirement to borrow from a Schedule I or II bank would restrict a fund from issuing debt securities. The ability for a fund to offer high yield debt securities would meet this investor demand, while providing existing equity holders with a longer term financing. In the current low interest rate environment, funds may be in the position to secure long term financing at historically low rates. One commenter thought that due to their nature, only a low level of liquidity is required on an ongoing basis for non-redeemable investment funds to cover recurring expenses. One commenter expressed concern that limiting borrowing to Canadian financial institutions would reduce competition and possibly increase borrowing costs for non-redeemable investment funds. Two commenters raised the issue that any restriction to limit borrowing to Canadian financial institutions may be in contravention of international trade agreements to which Canada is a party. One commenter identified leverage as being necessary	

	for non-redeemable investment funds to enter into transactions intended to hedge risk. One commenter felt limiting leverage to cash borrowings would limit a fund's ability to meet its objectives. Some non-redeemable investment funds employ the use of derivatives or short selling as a normal part of their portfolio. These funds, if no longer permitted to enter into these positions, may find it difficult or impossible to achieve their objectives and provide investors with returns similar to those provided in the past. In certain market conditions the ability to short-sell may be the fund's best opportunity to generate positive market returns. The ability to enter into these positions is a point of differentiation between non-redeemable investment funds and mutual funds, which investors expect. The commenter does not consider it appropriate to classify funds with these positions as alternative funds under Regulation 81-104 unless there are a set of separate rules for non-redeemable investment funds.	

Part IV – List of commenters

Commenters

- AGF Investments Inc.
- Alternative Investment Management Association (AIMA)
- Arrow Capital Management Inc.
- Artemis Investment Management Limited
- Aston Hill Capital Markets Inc.
- Blackheath Fund Management Inc.
- BlackRock Asset Management Canada Limited
- Blake, Cassels & Graydon LLP
- Borden Ladner Gervais LLP
- Brompton Funds Limited
- Canadian Advocacy Council for Canadian CFA Institute Societies, The
- Canadian Foundation for Advancement of Investor Rights (FAIR)
- Canadian Securities Institute, The (CSI)
- Canadian Securities Lending Association (CASLA)
- Canoe Financial LP
- CI Investments Inc.
- Cymbria Corp.
- Faircourt Asset Management Inc.
- Fasken Martineau DuMoulin LLP
- Fidelity Investments Canada ULC
- First Asset Investment Management Inc.
- Front Street Capital
- GD-1 Management Inc. and Global Digit II Management Inc.
- Harvest Portfolios Group Inc.
- IFSE Institute, The
- Investment Funds Institute of Canada, The (IFIC)

- Investment Industry Association of Canada, The (IIAC)
- Man Investments Canada Corp.
- Mark Brown
- McCarthy Tétrault LLP
- McMillan LLP
- Middlefield Group
- Morgan Meighen & Associates Limited
- Osler, Hoskin & Harcourt LLP
- Periscope Capital Inc.
- Private Mortgage Lenders Forum
- Propel Capital Corporation
- Quadravest Capital Management Inc.
- RBC Capital Markets
- RBC Global Asset Management Inc.
- ROI Capital
- Stikeman Elliott LLP
- Stikeman Elliott LLP (on behalf of 42 organizations)
- Stikeman Elliott LLP (on behalf of BMO Capital Markets, CIBC, National Bank Financial, RBC Capital Markets, Scotiabank and TD Securities)
- Strathbridge Asset Management Inc.
- TMX Group Limited
- Trez Capital Fund Management Limited Partnership
- W.A. Robinson Asset Management Ltd.
- Wildeboer Dellelce LLP