

## CSA Notice of Amendments Modernization of Investment Fund Product Regulation – Alternative Mutual Funds

**October 4, 2018**

### **Introduction**

The Canadian Securities Administrators (the **CSA** or **we**) are adopting amendments (the **Amendments**) to the following rules in order to implement the final phase of the CSA's Modernization of Investment Fund Product Regulation Project (the **Modernization Project**) relating to the establishment of a regulatory framework for alternative mutual funds:

- National Instrument 81-102 *Investment Funds* (**NI 81-102**),
- National Instrument 81-104 *Commodity Pools* (**NI 81-104**),
- National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**NI 81-101**),
- National Instrument 41-101 *General Prospectus Requirements* (**NI 41-101**),
- National Instrument 81-106 *Investment Fund Continuous Disclosure* (**NI 81-106**), and
- National Instrument 81-107 *Independent Review Committee for Investment Funds* (**NI 81-107**), and

(collectively, the **Amendments**).

In addition, we are publishing changes (the **Related Changes**) to Companion Policy 81-102CP to National Instrument 81-102 *Investment Funds* and are withdrawing Companion Policy 81-104CP to National Instrument 81-104 *Commodity Pools*.

Subject to Ministerial Approval Requirements, the Amendments and Related Changes will come into force on January 3, 2019.

### **Background**

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 Modernization Project has been carried out in phases. With Phase 1 and the first stage of Phase 2 now complete, the 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 Proposed Amendments*

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

The Proposed Alternative Funds Framework 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 NI 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*, in which we advised that the CSA had decided to consider the Proposed Alternative Funds Framework at a later date, in conjunction with certain investment restrictions for non-redeemable investment funds that we considered to be interrelated with the Proposed Alternative Funds Framework (the **Interrelated Investment Restrictions**), as part of the second stage of Phase 2 of the Modernization Project.

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.

On September 22, 2016, we published for comment draft amendments (the **Proposed Amendments**) to NI 81-102, NI 81-104, NI 41-101, NI 81-101 NI 81-106 and NI 81-107, which sought to codify a number of the parameters and proposals set out in the Proposed Alternative Funds Framework, as well as commentary we received in connection with those proposals. The Proposed Amendments were published for a 90 day comment period, and included a series of consultation questions intended to focus commentary on certain parts of the Proposed Amendments for which we sought specific feedback or commentary. We received 41 comment letters on the Proposed Amendments

## **Substance and Purpose**

Since NI 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 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 Amendments, while focused on alternative mutual 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 Amendments will move most of the regulatory framework currently applicable to commodity pools under NI 81-104 into NI 81-102 and rename these funds as "alternative mutual funds". They will also codify certain existing exemptive relief frequently granted to mutual funds, and include additional changes arising from the feedback received on the Proposed Alternative Funds Framework and the Proposed Amendments.

The key elements of the Amendments are outlined below.

### **(i) Defined term "Alternative Mutual Fund"**

The CSA is introducing a new category of mutual fund, "alternative mutual funds" which is being defined in NI 81-102. This term effectively replaces the term "commodity pool" that exists in NI 81-104. That term is being repealed to accommodate this change and existing commodity pools will become alternative mutual funds when the Amendments come into force.

The term "alternative mutual fund" refers to the mutual funds that have adopted investment objectives that permit those funds to invest in physical commodities or specified derivatives, or, borrow cash or engage in short selling in a manner not typically permitted for other mutual funds. This definition reflects the additional investment flexibility afforded to these types of funds and is intended to distinguish them from more conventional mutual funds (**conventional mutual funds**). Paragraph (ii) below describes the investment restrictions applicable to alternative mutual funds, the changes to the investment restrictions applicable to other mutual

funds, as well as the investment restrictions applicable to non-redeemable investment funds as part of the Interrelated Investment Restrictions.

## **(ii) Investment Restrictions**

### ***Concentration Restrictions***

Alternative mutual funds will be permitted to invest up to 20% of the fund's net asset value (NAV) at the time of purchase, in securities of a single issuer, under section 2.1 of NI 81-102. This is an increase from the current limit of 10% of NAV applicable to all mutual funds (including commodity pools) under that section. As part of the Interrelated Investment Restrictions, we are setting the same concentration limit for non-redeemable investment funds as will be applicable to alternative mutual funds.

The higher concentration limit for both alternative mutual 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***

Section 2.3 of NI 81-102 is being amended to permit conventional mutual funds to invest up to 10% of the fund's NAV in silver, platinum and palladium (including certificates representing those precious metals). This is in addition to investing in gold, which is already permitted under this section. This change reflects frequently granted exemptive relief.

Conventional mutual funds will also now be permitted under section 2.3 to obtain indirect exposure to any physical commodity (as that term is defined in NI 81-102) through the use of specified derivatives (as that term is defined in NI 81-102). This will be subject to the same 10% limit as direct investment in the above-referenced precious metals. In other words, conventional mutual funds will be subject to an overall 10% of NAV limit on direct or indirect investment in physical commodities.

We are also introducing subsections (3) and (4) to this section which provide a "look through" test for measuring compliance with this restriction for fund of fund investing.

As part of this change, we are introducing the new defined term "permitted precious metal" in NI 81-102 to refer to gold, silver, platinum or palladium and replacing the current term "permitted gold certificate" with "permitted precious metals certificate".

Under NI 81-104, commodity pools are exempt from the restrictions on investing in physical commodities under section 2.3 of NI 81-102 and this treatment is being maintained for alternative mutual funds under the Amendments. Non-redeemable investment funds are also exempt from these provisions and will remain exempt under the Amendments.

We are also introducing an exemption from the limits on investing in permitted precious metals for mutual funds that are "precious metals funds". This is a term currently defined in NI 81-104

which is being adopted as a definition within NI 81-102. These funds are defined as mutual funds other than alternative mutual funds that can invest substantially all of their assets in one or more permitted precious metals. The exemption from the restrictions on investing in physical commodities for these funds will only apply in respect of direct or indirect investment in permitted precious metals.

### ***Illiquid Assets***

Non-redeemable investment funds will now be subject to a limit on investing in illiquid assets under section 2.4 of NI 81-102. Under the Amendments, these funds will be permitted to invest up to 20% of their NAV at the time of purchase in illiquid assets with a hard cap of 25% of NAV.

The current limits on investing in illiquid assets applicable to mutual funds (including commodity pools) under section 2.4 of NI 81-102 are not being changed for alternative mutual funds.

### ***Fund-of-Fund Investing***

We are amending section 2.5 of NI 81-102 to permit alternative mutual funds to invest up to 100% of their net assets in any other investment fund subject to NI 81-102. Currently, commodity pools are restricted to investing only in conventional mutual funds that file a simplified prospectus.

We are also amending section 2.5 to permit conventional mutual funds to

- Invest up to 100% of their net assets in any other mutual fund (other than an alternative mutual fund) that is subject to NI 81-102, regardless of the form of prospectus they file, and
- Invest up to 10% of their net assets in alternative mutual funds or non-redeemable investment funds that are also subject to NI 81-102.

Currently, mutual funds are restricted to investing only in other mutual funds that file a simplified prospectus.

The fund of fund investing restrictions applicable to non-redeemable investment funds are not changing. The other restrictions on fund of fund investing, including multiple tiers or fee duplication will also remain unchanged.

### ***Cash Borrowing***

We are amending section 2.6 of NI 81-102 to permit alternative mutual funds to borrow cash up to 50% of their NAV, for investment purposes. These provisions will also apply to non-redeemable investment funds as part of the Interrelated Investment Restrictions.

In addition, cash borrowing for both alternative mutual funds and non-redeemable investment funds will be subject to the following requirements:

- funds may only borrow from entities that would qualify as an investment fund custodian or subcustodian under section 6.2 or 6.3 of NI 81-102, which essentially restricts borrowing to banks and trust companies (or their affiliates);
- where the lender is an affiliate or associate of the fund's investment fund manager, approval of the fund's independent review committee would be required under NI 81-107; and
- any borrowing agreements must be made in accordance with normal industry practice and be on standard commercial terms for agreements of this nature.

There will also be specific prospectus disclosure requirements regarding these borrowing arrangements under NI 41-101 and NI 81-101.

The current borrowing restrictions for mutual funds (including commodity pools) under section 2.6 of NI 81-102, which only permit them to borrow cash up to 5% of NAV on a temporary basis to fund redemption requests, will be unchanged for mutual funds that are not alternative mutual funds.

### ***Short Selling***

The short selling restrictions in section 2.6.1 are being amended to permit alternative mutual funds to short sell securities with a market value of up to 50% of the fund's NAV. This is an increase from the current limit of 20% of NAV applicable to all mutual funds including commodity pools.

Alternative mutual funds will be permitted to short sell securities of a single issuer (subject to the overall short-selling limit) up to 10% of NAV which is an increase from the 5% of NAV limit currently applicable to all mutual funds. This issuer concentration limit will not apply to the short sale of securities that are "government securities" as defined in NI 81-102.

Alternative mutual funds will also be exempted from subsections 2.6.1(2) and (3) of NI 81-102, which require funds to hold cash cover and generally prohibit the use of short sale proceeds to purchase other securities, which will allow for more flexibility in the use of this strategy by alternative mutual funds.

The short selling provisions applicable to alternative mutual funds as described above will also apply to non-redeemable investment funds as part of the Interrelated Investment Restrictions.

We are also amending section 6.8.1 of NI 81-102 to allow alternative mutual funds and non-redeemable investment funds to deposit assets up to 25% of NAV with a single borrowing agent (other than the fund's custodian or subcustodian) as security for short selling transactions. This is an increase from the 10% limit currently applicable to mutual funds (including commodity pools).

### ***Combined Limit on Cash Borrowing and Short Selling***

We are introducing section 2.6.2 which will provide an overall combined limit on cash borrowing and short selling by alternative mutual funds and non-redeemable investment funds, of 50% of NAV. This means that such a fund can only borrow cash and short sell concurrently if the combined amount does not exceed 50% of NAV.

### ***Aggregate Exposure to Borrowing, Short Selling and Specified Derivatives***

Under the Amendments, alternative mutual funds will be permitted to use leverage, both directly and indirectly, through cash borrowing, short selling and specified derivatives transactions. Currently, commodity pools are only permitted to create leverage indirectly through the use of specified derivatives.

In addition to restrictions on total short selling and cash borrowing described above, we are also introducing an overall limit on the use of borrowing, short selling and specified derivatives transactions. Under section 2.9.1 of NI 81-102, the aggregate exposure to these types of transactions will be limited to no more than 300% of the fund's NAV. Section 2.9.1 sets out how to calculate this.

To determine the aggregate exposure, the fund must add up the following and divide it by the fund's NAV:

- the value of any outstanding loans,
- the market value of its short positions, and
- the aggregate notional value of its specified derivatives positions, minus the aggregate notional value of those specified derivatives positions that are "hedging" transactions as that term is defined in NI 81-102.

Section 2.9.1 will also require funds to calculate this aggregate exposure as of any day on which the fund calculates a NAV and if the amount of exposure exceeds 300% of the fund's NAV, it must, as quickly as commercially reasonable, take all necessary steps to appropriately reduce that exposure.

As part of the Interrelated Investment Restrictions, this section will also apply to non-redeemable investment funds.

The Amendments include specific disclosure requirements both in an alternative mutual fund's prospectus and Fund Facts/ETF Facts, or a non-redeemable investment fund's prospectus as applicable, as well as in its financial statements regarding its use of leverage through these activities.

### ***Codification of Cleared Swap Exemptive Relief***

The Amendments include changes to certain provisions of NI 81-102 in order to codify existing relief granted to mutual funds regarding the use of cleared derivatives (the **Cleared Swaps Relief**). The Cleared Swaps Relief has been granted to mutual funds in order to facilitate their compliance with certain requirements 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 **Clearing Obligation Rules**), regarding the mandatory use of the facilities of a duly sanctioned clearing corporation for facilitating trade of certain over the counter (**OTC**) derivatives. The Clearing Obligation Rules are part of a global initiative to more tightly regulate the use of OTC derivatives, in response to the 2008 financial crisis. The changes described in this section will apply to all investment funds subject to NI 81-102.

The Cleared Swaps Relief consists of an exemption from the counterparty designated rating requirement in subsection 2.7(1) of NI 81-102, the counterparty exposure limits of subsection 2.7(4) of NI 81-102 and the custody requirements in section 6.8 of NI 81-102 in order to allow investment funds to deal with futures commissions merchants and clearing corporations for clearing OTC derivatives, in accordance with their rules. The applicable sections of NI 81-102 that are referenced in the Cleared Swaps Relief have been amended accordingly.

In connection with these changes, the Amendments also include the new defined term “cleared specified derivatives” which refers to any specified derivative accepted for clearing by a “regulated clearing agency”. The term “regulated clearing agency” is defined in National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*, (which is part of the CSA’s response to harmonize with the Clearing Obligation Rules) and refers to clearing agencies that are permitted to act as clearing houses under the Clearing Obligation Rules. That term has also been adopted into NI 81-102.

### ***Other derivatives provisions***

We are exempting alternative mutual funds from subsection 2.7(1) of NI 81-102, which will allow these funds to enter into specified derivatives transactions with counterparties that may not have an “approved credit rating”, which will give them access to a wider variety of counterparties for these transactions than is currently available to mutual funds under this section.

We are also amending the counterparty exposure limits in section 2.7(4) of NI 81-102 to limit an investment fund’s total exposure to any one counterparty under a specified derivatives transaction to 10% of the investment fund’s NAV on a mark-to-market basis. This limit already applies to conventional mutual funds, but will now also apply to alternative mutual funds and non-redeemable investment funds. The Amendments include an exemption whereby this limit will not apply in respect of a cleared specified derivative or if the applicable counterparty has a “designated rating”.

### **(iii) New Alternative Mutual Funds – Seed Capital Requirements**

Under the Amendments, all mutual funds will have the same seed capital and start-up requirements. Conventional mutual funds under Part 3 of NI 81-102 are required to have at least \$150,000 in seed capital, provided by either its manager or other related entities, at the time of launch. Furthermore, the manager (or other seed capital provider) is prohibited from withdrawing any portion of that seed capital until the mutual fund has received at least \$500,000 in subscriptions from outside investors. These requirements will also apply to alternative mutual funds.

As part of this change, we are repealing the seed capital requirements that apply to commodity pools under NI 81-104. These provisions had a lower minimum seed capital requirement of only \$50,000 and included a provision mandating that the minimum seed capital remain invested in the fund at all times.

### **(iv) Custody of Investment Fund Assets**

We are making a small technical change to the custody requirements described in subsections 6.2(3)(a) or 6.3(3)(a) to no longer require that an affiliate of a bank or trust company referred to in those provisions have financial statements that “have been made public”. This reflects the fact that in many cases, these affiliates are wholly-owned subsidiaries of an applicable bank or trust company and therefore may not have publicly available financial statements. All of the other requirements in these sections, including the requirement to have audited financial statements confirming that those entities meet the minimum asset threshold will remain unchanged.

### **(v) Amendments to NI 81-104**

#### ***Migration of key provisions into NI 81-102 and other Instruments***

While commodity pools are mutual funds and are subject to NI 81-102, NI 81-104 currently provides certain exemptions for commodity pools from the investment restrictions applicable to mutual funds under NI 81-102. Further to the goal of consolidating the operational framework and investment restrictions applicable to publicly offered investment funds within NI 81-102, the Amendments will migrate these exemptions from NI 81-104 into NI 81-102 and apply them to alternative mutual funds. Specifically, the exemptions from sections 2.3, 2.7, 2.8 and 2.11 of NI 81-102 that currently apply to commodity pools under NI 81-104 are being repealed from that Instrument and adopted within NI 81-102.

NI 81-104 includes other commodity-pool specific provisions that are also migrating to NI 81-102 and elsewhere and being applied to alternative mutual funds. The provisions in part 5, which governs performance fees payable by a commodity pool are being adopted within Part 7 of NI 81-102 and applied to alternative mutual funds. Similarly, Part 6 of NI 81-104, which has provisions that allow commodity pools additional flexibility on redemption obligations, is being adopted within Part 10 of NI 81-102 and applied to alternative mutual funds. The Amendments will also concurrently repeal these provisions from NI 81-104.

Finally, as will be discussed below, the financial statement disclosure provisions for commodity pools in Part 8 of NI 81-104 are being repealed from that Instrument and adopted into NI 81-106 and will apply to both alternative mutual funds and non-redeemable investment funds.

### ***Retention of Mutual Fund Dealer Proficiency Standards***

The only part of NI 81-104 that is being retained under the Amendments are the proficiency standards for mutual fund dealers distributing commodity pools in Part 4 of that Instrument. These are being amended to apply to alternative mutual funds and the Instrument is being renamed as “National Instrument 81-104 *Alternative Mutual Funds*” to reflect this.

These proficiency standards act to prevent a mutual fund restricted dealer representative from distributing alternative mutual funds unless they possess one of the following:

- passing grade on the Canadian Securities Course;
- passing grade on the Derivatives Fundamentals Course;
- successful completion of the Chartered Financial Analyst Program; or
- any applicable proficiency standard mandated by a self-regulatory agency

The decision to retain these proficiency standards is recognition that alternative mutual funds can be more complex than other types of mutual funds and that additional proficiency may be needed for mutual funds dealers selling these products. It is our view that maintaining the more robust dealer proficiency standards applicable to commodity pools will help ensure that mutual fund dealers are better equipped to sell these products. It also recognizes that the CSA is engaged in ongoing work with respect to these types of dealer-focused issues. We believe any significant changes to the dealer proficiency standards are best dealt with on a more holistic basis and retaining the existing proficiency standards is a means of not interfering with that work or causing unnecessary market disruption. When that work is completed, and an appropriate replacement for these standards is in place, we expect to repeal these provisions (and by extension fully repeal NI 81-104).

### **(vi) Disclosure**

#### ***Form of Prospectus/Point of Sale***

The Amendments include changes to NI 41-101 and NI 81-101 to fully bring alternative mutual funds within the prospectus disclosure regime applicable to other mutual funds.

Specifically, NI 81-101 is being amended so that it applies to any mutual fund that is not listed on an exchange. This means that alternative mutual funds that are not listed on an exchange will now prepare and file a simplified prospectus, annual information form and Fund Facts, with the Fund Facts having to be delivered at the point of sale.

Alternative mutual funds that are listed on an exchange will file a long form prospectus and ETF Facts under NI 41-101 and will have to comply with the point of sale delivery requirements applicable to the ETF Facts, as is the case with listed commodity pools today.

In addition, the applicable forms to those Instruments are being amended to require certain additional disclosure specific to alternative mutual funds and non-redeemable investment funds (where applicable).

Alternative mutual funds will have to provide certain prescribed textbox disclosure highlighting how the alternative mutual fund differs from conventional mutual funds, as well as additional disclosure regarding their lenders (if the fund intends to borrow cash) and the use of leverage. The text box disclosure referred to above as well as the disclosure regarding use of leverage will also have to be provided in the Fund Facts/ETF Facts.

Non-redeemable investment funds that file a prospectus will have to provide the disclosure regarding their lenders and the use of leverage referenced above.

### ***Financial Statement Disclosure***

As noted above, Part 8 of NI 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**).

The Leverage Disclosure Requirements are being repealed from NI 81-104 and adopted into NI 81-106 and will apply to both alternative mutual funds and non-redeemable investment funds. The disclosure will be required for both the fund's financial statements and for the fund's management report on fund performance. Funds will also have to provide disclosure about the impact of hedging transactions on the fund's overall leverage calculations.

### **(vii) Transition/Grandfathering**

The CSA are providing transition periods to grant existing commodity pools additional time after the Amendments come into force to make any necessary operational changes in order to comply with the Amendments. Commodity pools will become alternative mutual funds once the Amendments come into force.

Existing non-redeemable investment funds will also be exempted from certain of the investment restrictions in the Amendments subject to certain conditions.

### **Adoption Procedures**

The Amendments will 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 81-102 CP Changes will be adopted as part of policies in each of the CSA jurisdictions.

## **Local Matters**

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

## **Summary of Comments**

We received submissions from 41 commenters on the Proposed Amendments and we thank each of those commenters for their submissions. A summary of those comments together with our responses is provided in Annex B to this Notice.

## **Summary of Changes to the Proposed Amendments**

After considering the comments received, we have made some revisions to the materials that were initially published for comment under the Proposed Amendments. These revisions are reflected in the Amendments (including the Related Changes) that we are publishing as Annexes C to I of this Notice. We do not consider these changes to be material and accordingly, we are not publishing the Amendments for a further comment period. A summary of the key changes to the Proposed Amendments is provided in Annex A to this Notice.

## **Questions**

Please refer your questions to any of the following CSA staff:

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## **Contents of Annexes**

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

**Annex A** – Summary of Changes to the Proposed Amendments

**Annex B** – Summary of Public Comments and CSA Responses on the Proposed Amendments

**Annex C-1** - Amendments to National Instrument 81-102 *Investment Funds*

**Annex C-2** – Changes to Commentary to National Instrument 81-102 *Investment Funds*

**Annex – C3** - Changes to Companion Policy 81-102CP to National Instrument 81-102 *Investment Funds*

**Annex D-1** – Amendments to National Instrument 81-104 *Commodity Pools*

**Annex D-2** - Withdrawal of Companion Policy 81-104CP to National Instrument 81-104 *Commodity Pools*

**Annex E** –Amendments to National Instrument 41-101 *General Prospectus Requirements*

**Annex F** - Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

**Annex G** –Amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure*

**Annex H-1** – Amendments to National Instrument 81-107 *Independent Review Committee for Investment Funds*

**Annex H-2** – Changes to Commentary to National Instrument 81-107 *Independent Review Committee for Investment Funds*

**Annexe I** – Local Matters

## ANNEX A

### SUMMARY OF CHANGES TO THE PROPOSED AMENDMENTS

**This document summarizes the changes we made to the Proposed Amendments in response to the comments received. We do not consider these changes to be material.**

#### **Changes to NI 81-102**

##### *Part 1 - Definitions*

1. The defined term “alternative fund” has been changed to “alternative mutual fund”. The definition was also amended to specifically exclude “precious metals funds” from that definition.
2. The definition of “cleared specified derivatives” has been amended to refer only to a specified derivative accepted for clearing by a “regulated clearing agency”, which is a term defined in National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (NI 94-101). This change was made to eliminate redundancies in the definition which became unnecessary once NI 94-101 came into force.
3. The definition of “public quotation” has been amended to include a reference to quotation of a price for a foreign currency forward or foreign currency option in the interbank market. This additional interpretation was initially part of NI 81-104 and has been adopted into NI 81-102 as part of the migration of the various provisions from that Instrument into NI 81-102.

##### *Part 2 - Investments*

4. Subsection 2.5(5) was amended to allow an investment fund to pay brokerage commissions to invest in any exchange traded mutual fund, instead of only those that issue “index participation units”. This aligns with the change to the fund of fund restrictions that will among other things, allow mutual funds to invest in ETFs, or up to 10% of NAV in alternative mutual funds (including those that are ETFs) and non-redeemable investment funds.
5. Subsection 2.6(2) was changed to clarify that the borrowing provisions for alternative mutual funds and non-redeemable investment funds also permit those funds to grant a security interest over their assets, which is similar to the existing borrowing provisions in section 2.6.
6. Subsection 2.6(2) was also changed to expand the scope of permitted lenders to an alternative mutual fund or non-redeemable investment fund to include entities defined in section 6.3 of NI 81-102. This includes foreign banks and trust companies and certain

affiliates that are permitted to act as subcustodians for non-Canadian assets of investment funds. This is in addition to permitted lenders in the Proposed Amendments, which were entities defined in section 6.2 of NI 81-102.

7. The short selling restrictions applicable to alternative mutual funds and non-redeemable investment funds in section 2.6.1 of NI 81-102 in the Proposed Amendments were changed to exempt “government securities” (as that term is defined in NI 81-102) from the short-selling issuer concentration restrictions in that section.

8. The counterparty exposure provisions for specified derivatives transactions in subsection 2.7(4) as set out in the Proposed Amendments were changed to also provide an exemption from the counterparty exposure limit in that section for counterparties that have a “designated rating”. This is in addition to the exemption for cleared specified derivatives that was in the Proposed Amendments.

9. The calculation methodology for the purposes of determining an alternative mutual fund’s or non-redeemable investment fund’s aggregate exposure to borrowing, short selling and specified derivatives in section 2.9.1 of NI 81-102 in the Proposed Amendments has been amended to permit those funds to subtract the aggregate notional value of their specified derivatives positions arising from “hedging” transactions (as that term is defined in NI 81-102), from the aggregate notional value of their specified derivatives positions.

#### *Part 6 – Custodianship of portfolio assets*

10. We have removed the requirements in subsections 6.2(3)(a) and 6.3(3)(a) that an affiliate of a bank or trust company referred to in sections 6.2 and 6.3 must have financial statements that are “publicly available” in order to act as a fund custodian or subcustodian under those sections.

11. Section 6.8.1 was changed to allow an alternative mutual fund or non-redeemable investment fund to deposit up to 25% of its net assets as margin in connection with a short sale of securities, with a borrowing agent that is not the fund’s custodian or subcustodian.

#### *Grandfathering of existing non-redeemable investment funds*

12. We have included provisions that will grandfather certain pre-existing non-redeemable investment funds from the investment restrictions otherwise applicable to non-redeemable investment funds in sections 2.1, 2.4, 2.6, 2.6.1, and 2.9.1 under the Amendments.

#### *Appendix F – Investment Risk Classification Methodology*

13. We have added guidance in the Commentary to Item 1 regarding additional considerations to take into account when using the investment risk classification

methodology (the Methodology) in respect of a fund that uses strategies in which the Methodology may not fully reflect the fund's risk level because of an atypical performance distribution - including using a manager's "upside discretion" in assigning a risk rating. The Methodology was not in force at the time of the Proposed Amendments.

#### **Changes to NI 81-104**

14. We have retained the mutual fund dealer proficiency requirements in Part 4 of NI 81-104 and have amended them to apply to alternative mutual funds. Accordingly, NI 81-104 is no longer being repealed entirely (as was proposed under the Proposed Amendments). All of the other provisions from that Instrument, with the exception of the dealer proficiency requirements in Part 4, are still being repealed or migrated to other Instruments as initially proposed in the Proposed Amendments.

#### **Changes to NI 41-101**

15. The definition of "alternative mutual fund" was added to NI 41-101.

16. We amended Form 41-101F4 *ETF Facts* to include alternative mutual fund-specific disclosure similar to the Fund Facts disclosure requirements under NI 81-101 that were in the Proposed Amendments. This is due to Form 41-101F4 not having been in force at the time the Proposed Amendments were published.

## ANNEX B

### SUMMARY OF PUBLIC COMMENTS AND CSA RESPONSES ON CSA NOTICE AND REQUEST FOR COMMENT *MODERNIZATION OF INVESTMENT FUND PRODUCT REGULATION – ALTERNATIVE FUNDS*

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PART	TITLE
Part I	BACKGROUND
Part II	GENERAL COMMENTS ON THE PROPOSED AMENDMENTS
Part III	COMMENTS IN RESPONSE TO CONSULTATION QUESTIONS
Part IV	LIST OF COMMENTERS

#### Part I – BACKGROUND

##### Summary of Comments

On September 22, 2016, the Canadian Securities Administrators (CSA) published for comment proposals to repeal National Instrument 81-104 *Commodity Pools*, (NI 81-104) and to amend National Instrument 81-102 *Investment Funds*, (NI 81-102), National Instrument 41-101 *General Prospectus Requirements* (NI 41-101), National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106), and National Instrument 81-107 *Independent Review Committee for Investment Funds* (NI 81-107) (the **Proposed Amendments**). The Proposed Amendments represent the final phase of the CSA’s ongoing policy work to modernize investment fund product regulation and are aimed at developing a more comprehensive regulatory framework for mutual funds that seek to make use of more “alternative” investment strategies (**alternative mutual funds**).

We received submissions from 41 commenters in respect of the Proposed Amendments. The name of each commenter listed in Part IV of this Summary of Comments. We wish to thank all of those who took the time to comment.

**Part II - GENERAL COMMENTS ON THE PROPOSED AMENDMENTS**

<u>ISSUE</u>	<u>COMMENTS</u>	<u>RESPONSES</u>
<p><b>General comments</b></p>	<p>There was widespread support for the proposals, with some commenters noting that the CSA should help to facilitate Canadian investors having access to similar types of funds that are sold to retail investors in other jurisdictions like Europe and the United States.</p> <p>Another commenter however, expressed concerns about a level playing field and was worried that the Proposed Amendments may unduly favour larger institutions at the expense of smaller firms.</p> <p>Two commenters support the proposal to divide publicly-offered investment funds into 3 categories and to bring them all within NI 81-102 and recommended that the CSA provide some clarity in the Companion Policy to NI 81-102 (the CP) around these categories and the implications of being one or the other as there may be some overlap in what the various types of funds can do.</p> <p>A different commenter urged caution in distinguishing</p>	<p>We thank the commenter for the support.</p> <p>It is not the intent of the Amendments to favour larger institutions.</p> <p>We thank these commenters for the support. We note that under the Amendments, the terms “non-redeemable investment fund” and “alternative mutual fund” will be defined in NI 81-102, and that Instrument will clearly indicate which of the various investment restrictions will apply to which type of investment fund. We do not believe it is necessary therefore to also provide a summary of the differences between these types of funds in the Companion Policy to that Instrument.</p> <p>The concern is noted.</p>

	<p>between alternative and conventional funds and the strategies they can use as any ambiguity could be exploited by some industry participants, misleading investors.</p> <p>Some commenters recognized the opportunities that can come with expanded investment strategies and that there could be investor demand for these products but seemed to view this as more of an industry-driven initiative. These commenters expressed concern with the possible risks to retail investors of these new strategies and believe that it further emphasizes the need for the CSA to implement a regulatory best interest standard for anyone giving financial advice and that there should be proper training for dealers to ensure they understand these products and how they are different from more conventional mutual funds.</p> <p>A different commenter expressed concern about what it believes is the lack of enforcement of current restrictions under National Instrument 81-105 <i>Mutual Fund Sales Practices</i> and worries this may lead to more issues under a new alternative funds regime.</p> <p>A different commenter suggested that the CSA fundamentally reconsider its approach to regulation and that risk should be judged on what is being distributed rather than how. This commenter believes that any assumption that a prospectus-qualified product is inherently less risky than an exempt product is an outdated view.</p>	<p>The concern is noted. We also note that some of these issues are being considered as part of the CSA's Client Focused Reforms Project.</p> <p>The concern is noted. Please see our response above.</p> <p>The concern is noted. However, a fundamental reconsideration of the CSA's approach to regulation in the manner this comment contemplates is beyond the scope of this Project.</p>
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	<p>We were also urged to undertake a public education campaign in conjunction with the industry to inform investors about the features, risks and benefits of investing in alternative funds.</p>	<p>We have noted this suggestion and will refer it to our respective Communications and Investor Outreach teams.</p>
<p><b>Naming Conventions</b></p>	<p>A number of commenters supported the decision not to propose a naming convention for alternative funds.</p> <p>These commenters also told us that the terms “alternative fund” or “conventional mutual fund” should only be used as a descriptor for the sake of convenience, not as defined terms, and that it should be left to the product disclosure to highlight the characteristics and differences between these products, while other commenters suggested that clarification be provided in the CP.</p> <p>Other commenters suggested a naming convention mandating the use of the term “non-conventional mutual fund” for these products and that this will be more meaningful to investors than the term “alternative fund” which may not be well understood. These commenters added that this naming convention would help to protect investors.</p>	<p>We thank the commenters for the support.</p> <p>We note that the term “conventional mutual fund” is not used as a defined term under the Amendments. We decided to create a defined term “alternative mutual fund” as a means of distinguishing these products from other types of mutual funds for the purposes of more clearly articulating the different regulatory requirements that will apply to these funds, such as different investment restrictions and disclosure requirements. This is similar to the approach that was taken with commodity pools under NI 81-104. Commodity pools will become alternative mutual funds under the Amendments.</p> <p>As noted above, we are not proposing a naming convention for alternative mutual funds. This is consistent with our current approach on naming conventions - commodity pools are not required to use that term in their names, nor are there prescribed naming requirements for non-redeemable investment funds.</p> <p>The defined term “alternative mutual fund” is meant to differentiate these funds from other types of mutual funds for regulatory purposes, as there are different</p>

		requirements applicable to them versus other mutual funds. This is similar to the manner in which the term “commodity pool” was used under NI 81-104. The prospectus disclosure requirements will also require these funds to describe themselves as alternative mutual funds in order to avoid any investor confusion.
<b>National Instrument 81-102 <i>Investment Funds</i></b>		
<b>Part I – Definitions</b>		
<b>“Alternative Fund”</b>	<p>One commenter suggested that while the proposed definition of “alternative fund” contemplates that it is the fund’s investment objectives that determine if it is an alternative, it may actually be the fund’s investment strategies that are more important for this definition. The commenter added that the definition should be revised to make it clear that either the fund’s investment objectives or strategies can make it an alternative fund.</p> <p>This commenter also asked that we provide wording in the CP to clarify that it is not intended for all precious metals funds to be alternative funds, and that simply investing in precious metals should not in itself make a mutual fund a precious metals fund.</p>	<p>Change not made. We are of the view that in order to avail itself of the more flexible investment strategies available to alternative mutual funds, it must be part of the fund’s fundamental investment objectives to pursue these strategies. We don’t agree that just referencing this in the investment strategies, which can be amended at any time without securityholder approval, is sufficient. We note that this is consistent with the approach that was taken for the definition of “commodity pool” under NI 81-104, which “alternative mutual fund” is replacing as a defined term.</p> <p>We have amended the definition of alternative mutual fund to better clarify that it excludes precious metals funds.</p> <p>We also note that the definition of “precious metals fund” requires that investing primarily in permitted</p>

		precious metals be the fund’s fundamental investment objective. Incidental investment in permitted precious metals by a mutual fund will not in itself make the mutual fund a “precious metals fund.”
<b>“Cleared Specified Derivative”</b>	One commenter stated that this proposed definition does not distinguish between futures commissions merchants that execute and clear exchange traded derivatives and clearing corporations that clear over-the-counter (OTC) derivatives. This commenter noted that this blurring of functions is not currently an issue but could become one as new derivatives rules are refined in Canada and internationally and suggested separate definitions to more clearly distinguish these functions.	The definition now clarifies that a “cleared specified derivative” is one that is accepted for clearing by a “regulated clearing agency”, which is a term defined in National Instrument 94-101 <i>Mandatory Central Counterparty Clearing of Derivatives</i> .
<b>“Designated Rating”</b>	<p>One commenter noted recent financial events resulting in rating downgrades in the US and elsewhere, and that the pool of counterparties that would have a “designated rating” as that term is currently defined, has been materially reduced. This means that investment funds subject to NI 81-102 are forced to use a more concentrated pool of counterparties. This commenter recommended that CSA consider articulating certain limited exemptions to the designated rating requirements in NI 81-102, where there has been an industry-wide rather than institution-specific downgrade that may disrupt a manager’s existing counterparty arrangements.</p> <p>Another commenter suggested adopting the definition of “designated rating” used in NI 44-101, which is a lower threshold than the term as defined in NI 81-102.</p>	<p>Change not made. There are other more appropriate means for dealing with an exceptional scenario like that occurring in the marketplace, such as applying for exemptive relief.</p> <p>Change not made. A change of that nature is beyond the scope of this Project. We also note the ongoing CSA project concerning possible amendments to National Instrument 25-101 <i>Designated Rating</i></p>

		<p><i>Organizations</i> which may be more directly relevant to this comment.</p>
<p><b><i>“Illiquid Asset”</i></b></p>	<p>Some commenters suggested that the definition of “illiquid asset” in NI 81-102 is problematic in that defining an asset as illiquid because it does not trade on a market that has public or widely available quotations is too narrow, particularly as applied to fixed income securities, which can have deep and very liquid markets for trading.</p> <p>Some of these commenters suggested the definition be amended such that securities that trade in OTC markets can be liquid if they are actively traded on such markets.</p> <p>Another commenter believes that securities that can be readily traded for their appropriate value on a market that provides full pre-trade transparency to all participants in that market should be deemed liquid for the purposes of that definition.</p> <p>Other commenters encouraged the CSA to consider adopting an “SEC-type” definition of illiquid asset, which focuses on the ability to dispose of an asset at its fair value within a prescribed period of time, modified to meet any policy objective specific to the Canadian markets. These commenters argue that this is a more flexible approach and is easier to apply in practice than the current definition.</p>	<p>We received a number of comments concerning changes to this definition and to the provisions governing illiquid assets held by funds generally. However, we are of the view that amending the regulatory framework and terminology regarding illiquid assets in this manner is beyond the scope of this Project as its impact would extend beyond just alternative mutual funds and strategies.</p> <p>Change not made. An amendment of this nature is beyond the scope of this Project. Please see our response above.</p> <p>Change not made. An amendment of this nature is beyond the scope of this Project. Please see our response above.</p> <p>Change not made. Amending the definition in this manner would be beyond the scope of this Project. Please see our response above.</p>

	<p>One commenter questioned why the additional interpretation “public quotation” in NI 81-104, which pertains to the definition of “illiquid asset” in regards to foreign currency forwards and options in the interbank market, was not carried into NI 81-102 as part of the Proposed Amendments.</p> <p>We also heard from commenters that consideration of the scope of the definition of “illiquid asset” in NI 81-102 requires further commentary and consultation and should not necessarily be tied to the alternative funds proposal and the Proposed Amendments.</p>	<p>The definition of “public quotation” in NI 81-102 has been amended to include this additional wording from NI 81-104.</p> <p>We agree.</p>
<b><i>“non-redeemable investment fund”</i></b>	<p>One commenter suggested incorporating and updating the discussion that is in the Companion Policy to NI 81-106 about what is and isn’t an NRIF, into the Companion Policy to NI 81-102. This commenter also suggested including some discussion points from recent CSA Notices that also discussed this topic since they believe this distinction is not very well understood.</p>	<p>Change not made. The definition of “non-redeemable investment fund” refers back to NI 81-106, which would necessarily include any commentary in the Companion Policy to that Instrument.</p>
<b><i>“Precious Metals Funds”</i></b>	<p>One commenter noted that the definition of “precious metals fund” in NI81-104 permits these funds to invest both directly in precious metals and in entities that invest in precious metals, which has been interpreted as including securities of companies that operate in the precious metals sector or industry. This commenter noted that this part of the definition was not carried into NI 81-102 as part of the Proposed Amendments and suggested we reconsider that decision.</p>	<p>Change not made. The definition is intended to capture funds that focus on direct or indirect investment in precious metals, such as gold, silver or platinum, which is consistent with exemptive relief previously granted and with the exemptions from the general restrictions on mutual funds investing in commodities. We don’t believe a fund that invests primarily in equity securities of firms in the precious metal sector is the same thing as a “precious metals fund”, from this perspective. We note however, that the definition does not necessarily</p>

		prohibit a precious metals fund from also investing in equity securities of companies in that sector.
<b><i>Other terminology</i></b>	We heard from one commenter that NI 81-102 contains derivatives-related terminology that is vague and inconsistent with terms used by market participants.	The concern is noted. However, a review of this nature is beyond the scope of this Project.
<b>Part 2 – Investments</b>		
<b>Section 2.3 - Restrictions Concerning Types of Investments</b>	One commenter believes the exclusion to the proposed look through test in subsection 2.3(4) should be more broad to also exclude investment by an investment fund in an underlying fund if the top fund represents less than 10% of the underlying fund’s NAV.	Change not made. The look through test is intended to be consistent with similar look through provisions applicable to the general concentration restrictions in section 2.1.
<b>Section 2.4 - Restrictions Concerning Illiquid Assets</b>	<p>One commenter recommended increasing illiquid asset limit for alternative funds to the same 15% of NAV limit applicable for mutual funds in the US, noting that the SEC originally increased this limit from 10% as a way of providing more capital for small business investment without significantly increasing risk to mutual funds. This commenter suggests this change would have a similar effect in Canada.</p> <p>Another commenter also encouraged the CSA to consider an increase in the illiquid asset limits for conventional mutual funds, specifically to 15% of NAV at time of purchase with a 20% of NAV hard cap. This commenter suggested this would allow mutual funds to better participate in long term infrastructure projects or private equity opportunities.</p>	<p>Change not made. We are not contemplating any changes to the illiquid asset thresholds for mutual funds under NI 81-102 as part of this Project as noted in our earlier responses above.</p> <p>Change not made. Please see our response above.</p>
<b>Section 2.5 – Investment in Other Mutual Funds</b>	Several commenters suggested we increase the limit on investment in alternative funds or NRIFs by mutual funds from 10% of NAV to 20%, as they are all subject to NI 81-102, and because this would give mutual	Change not made. We think 10% is an appropriate balance between giving mutual funds access to these types of investments or strategies without altering the fundamental nature of the mutual funds. It will also

<p>funds greater access to more flexible investment strategies.</p> <p>One of those commenters added that this 20% aggregate limit could include a 10% cap on investment in any single alternative fund or NRIF, with an added requirement that this be in the mutual fund's investment objectives or strategies.</p> <p>Another commenter believes there should be no restriction on investment by a mutual fund in any underlying fund, whether or not it is subject to NI 81-102. This commenter notes that the funds are managed by sophisticated professionals who do not need the same protection as retail investors.</p> <p>We were commended by one commenter for codifying certain existing fund of fund relief for mutual funds as part of the Proposed Amendments. This commenter suggested we also consider codifying other existing relief that allows mutual funds to invest in ETFs traded in jurisdictions outside of Canada subject to certain conditions.</p> <p>One commenter suggested that we prohibit mutual funds from investing in alternative funds or NRIFs, adding that the proposal could make it much harder for investors to use basic asset allocation principles in</p>	<p>help to reduce market confusion by limiting any overlap in strategies used by mutual funds vs alternative mutual funds so that these types of funds are more clearly distinguished from one another.</p> <p>Change not made. Please see our response above.</p> <p>Change not made. Part of the basis for the fund of fund restrictions is to ensure that funds cannot access assets and strategies through fund of fund investing that they cannot access directly. A change of this nature is inconsistent with that goal since it would allow unfettered access, through fund of fund investing, to strategies and investment that retail mutual funds are not permitted to use directly.</p> <p>Change not made. The CSA has considered and, in some cases, granted exemptive relief on a case-by-case basis to allow mutual funds to invest in ETFs traded in jurisdictions outside of Canada, and continue to believe this is the best approach going forward. However, we may consider revisiting this approach in the future.</p> <p>Change not made. The original proposal in part reflects exemptive relief previously granted to allow mutual funds a limited degree of exposure to commodity pools or NRIFs. We believe codifying this</p>
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	<p>constructing their portfolios and recommends that fund purity be maintained.</p> <p>A different commenter suggested that before adopting this change, stakeholders should be provided with information that demonstrates that this will be advantageous to investors who invest in these funds and whether the increased cost and decreased liquidity will be in the best interest of fund investor.</p>	<p>restriction is consistent with those previous orders and that the level of permitted investment in alternative mutual funds and NRIFs is sufficiently limited as to allow those funds to have some degree of exposure to strategies associated with these products, without impacting the fundamental nature of the mutual fund.</p> <p>We note that mutual funds that choose to make these investments are required to properly disclose this to investors and that any dealers selling these funds have suitability and “know your product” obligations under securities law.</p>
<p><b>Section 2.6 – Investment Practices</b></p>	<p>We heard from commenters that alternative funds or NRIFs should be permitted to deduct cash or cash equivalents on hand from the proposed cash borrowing limit of 50% of NAV.</p> <p>Another commenter supported the 50% limit generally but expressed concern that the restrictions placed on which entities can lend cash to alternative funds may increase borrowing costs by reducing competition. There was also concern expressed that limiting cash borrowing to 50% of NAV may push funds towards greater use of derivatives which may introduce more risk to achieve strategies.</p>	<p>Change not made. The purpose of the restriction is to limit the leverage that an alternative can use through cash borrowing. Cash on hand does not in itself reduce the amount of an outstanding loan unless it is applied towards the repayment of that loan.</p> <p>We have expanded the scope of entities permitted to act as lender to include those described under section 6.3 of NI 81-102, such as foreign banks or trust companies and their affiliates.</p> <p>We believe the limit of 50% of NAV on cash borrowing is an appropriate limit for introducing this strategy into the retail space in Canada and note that it is consistent with similar restrictions on this activity in other jurisdictions.</p>

	<p>One commenter doesn't believe NRIFs should be subject to any cash borrowing limits as their liquidity needs are very different than for mutual funds, and suggested we remove the proposed limits for NRIFs.</p> <p>Another commenter suggested the following changes to the cash borrowing proposals:</p> <ul style="list-style-type: none"> <li>• Fixed income funds should be permitted to exceed the 50% of NAV limit.</li> <li>• Funds borrowing in specific foreign currencies should not be subjected to any cash borrowing limits as long as the fund retains an overall cash positive balance.</li> <li>• Alternative funds should also have the ability to use one or more custodians or prime brokers for borrowing cash and holding portfolio assets.</li> </ul>	<p>Change not made. We don't believe it is appropriate for a product designed to be sold to retail investors to have potentially unlimited leverage. We also note that many NRIFs already in the Canadian marketplace that borrow cash have self-imposed borrowing limits that are consistent with the limits set out in the Amendments. However, as part of the transition provisions for the Amendments, existing NRIFs that have investment objectives that would be inconsistent with this limit are exempted from complying with this restriction, although it will apply to all new NRIFs on a going forward basis.</p> <p>Changes not made. We're of the view that it is unduly complicated to establish multiple limits tied to any one fund's investment strategies, which can differ widely even amongst a particular fund type. We think that a single limit applicable to each defined type of fund is more manageable and appropriate. We think there are other avenues for addressing fund or strategy specific concerns with this, such as applying for exemptive relief.</p> <p>We note that the borrowing provisions in the Amendments do not prohibit alternative mutual funds from using more than one lender, or from borrowing from a prime broker. We further note that the criteria for an acceptable lender that was in the Proposed Amendments has been expanded to include foreign banks and their affiliates as well.</p>
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<p>We also heard from two commenters that stated that they do not believe that investors are well served in liquid markets through persistent borrowing of non-negligible amounts for investment purposes. They also noted however, that in the case of illiquid assets, the ability to borrow on a long term structural basis for the purpose of providing additional investment return may be suitable.</p> <p>One of the commenters suggested limiting cash borrowing to 10% of NAV on an incidental/short term basis for day to day management purposes (as opposed to generating leverage or return), and then granting exemptions on a case by case basis through relief, which would then require a demonstration of the rationale for such borrowing.</p> <p>We received support for the proposal that IRC approval be required for funds that seek to borrow cash from an affiliate of the investment fund manager and that the lending be under standard commercial terms.</p> <p>However, one commenter didn't agree that IRC approval should be necessary as it takes the view that borrowing cash from an affiliate of the manager is not materially different from other related party agreements for which IRC approval is not required, such as portfolio management or other services.</p>	<p>We agree that these types of strategies may not be appropriate for all investors and note that alternative mutual funds are not necessarily intended for all investors. However, we do recognize that the ability to borrow cash for investment purposes can be a useful tool for funds with a focus on alternative investment strategies and therefore are proposing to allow it but with what we believe to be appropriate safeguards. We expect an alternative mutual fund's portfolio manager to only employ this strategy where it believes it is appropriate to do so taking into account market conditions and the fund's own investment objectives.</p> <p>Change not made. Please see our response above.</p> <p>We thank the commenters for their support. We note that this approval requirement also includes entities that are associates of the investment fund manager as well.</p> <p>Change not made. We believe that a transaction of this nature is within the scope of the types of conflicts of interest for which IRC approval should be required.</p>
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	<p>We also received a number of comments regarding technical fixes to the cash borrowing proposals in section 2.6, to better clarify how the proposed cash borrowing provisions for alternative funds and NRIFs in subsection 2.6(2) in the Proposed Amendments interact with the existing provisions for temporary borrowing in subsection (1):</p> <ul style="list-style-type: none"> <li>• We received a suggestion that we add wording to clarify that the general restriction on borrowing in subsection (1) of section 2.6 be subject to the expanded limits proposed in subsection (2).</li> <li>• We were also asked to clarify in subsection (2) that alternative funds and NRIFs are permitted to provide a security interest over their assets for permitted cash borrowing as is the case in subsection (1).</li> <li>• We were also asked to clarify that borrowing under this section refers only to borrowing cash.</li> </ul>	<p>We have amended the wording in subsection (2) to make it more clear how it interacts with the limits in subsection (1).</p> <p>That is correct. Funds that can borrow cash in accordance with subsection 2.6(2) may also provide a security interest over their assets to facilitate the cash borrowing consistent with the existing provision in section 2.6. This has been clarified in subsection (2).</p> <p>That is correct. Other forms of borrowing, like short-selling are addressed in separate sections of NI 81-102.</p>
<p><b>Section 2.6.1 – Short Sales</b></p>	<p>There was support for the proposed 50% short selling limit as a prudent approach for alternative funds. One commenter however, recommended we revisit the limit after a full market cycle or 5 years, to determine how funds performed and to consider appropriate adjustments.</p> <p>There was also concern expressed that the limits were too low and could push funds towards possibly riskier</p>	<p>We thank the commenters for the suggestion. The CSA does review its rules from time to time to determine if they require updating or amending. We also note that the CSA also has the ability to address more specific concerns that may arise through exemptive relief orders.</p> <p>We believe that the proposed short-selling limits are appropriate for these products. We also note that the</p>

	<p>derivatives strategies to meet their investment objectives.</p> <p>Several commenters recommended that the short selling and borrowing restrictions be modified to allow 100% short selling as part of a “market neutral” strategy. Some of the commenters also suggested that we create a defined term “market neutral fund” to facilitate this.</p> <p>We were also asked by several commenters to exempt securities that qualify as “government securities” or “index participation units” under NI 81-102, from the short selling issuer concentration limits, on the basis that they are essentially “risk free” securities and are often used for hedging purposes.</p> <p>Some of the commenters suggested a blanket exemption from the limits for short selling when used for hedging purposes, and the language in the CP can be added to clarify what this would mean.</p> <p>Another commenter suggested we raise the short selling issuer concentration limit to 20% of NAV.</p> <p>A different commenter suggested the proposed 10% limit on a single issuer coupled with the 50% overall</p>	<p>Amendments include overall restrictions on leverage which also help mitigate the risk to these funds.</p> <p>Change not made. We believe a carve-out or exemption of this nature for a specific fund strategy like this can be better addressed through other means.</p> <p>Government securities, as defined in NI 81-102, have been exempted from the issuer concentration limits under the short-selling restrictions for alternative mutual funds and NRIFs under the Amendments.</p> <p>Change not made. The proposed short-selling limits for alternative mutual funds are devised in the same manner as for other mutual funds, which do not allow for exemptions for short-selling used for hedging purposes.</p> <p>Change not made. The increase in the issuer concentration limit on short selling was put in place to approximate the alternative mutual fund concentration limit for long positions. Since short selling is restricted to 50% of NAV, the equivalent to the 20% concentration limit on long positions is 10%.</p> <p>Change not made. Please see our response above. We expect that portfolio managers will determine whether</p>
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	<p>limit on short-selling shows little understanding of risk management in a long/short portfolio.</p> <p>We also heard that NRIFs should not have any short selling restrictions in recognition of the structural differences between NRIFs and mutual funds including alternative funds.</p> <p>We were also asked to consider easing the cash cover requirements for short sales by conventional mutual funds as well. This commenter suggested that managers are reluctant to use short selling strategies other than for hedging purposes since the current restrictions can result in a drag on performance. This commenter added that this will enable conventional mutual funds to consider the use of market neutral strategies as well.</p>	<p>or not taking full advantage of this limit is necessary or appropriate for their funds. We also note that these limits were not established solely for the purposes of use in long/short strategies.</p> <p>Change not made. We do not believe unfettered short-selling discretion is appropriate for funds directed at retail investors, though we note that NRIFs will be subject to the same limits on short selling as alternative mutual funds. We do not agree that any structural differences with NRIFs necessarily warrant allowing unlimited short selling.</p> <p>Change not made. The CSA's views on the restrictions on the use of leverage by conventional mutual funds have not changed.</p>
<p><b>Section 2.6.2 - Total Borrowing and Short Selling</b></p>	<p>Another commenter suggested that short selling be permitted up to 100% of NAV, and that funds be permitted to borrow up to 10% cash for operational needs and therefore recommends a combined borrowing/short selling limit of 110%.</p> <p>Another commenter did not agree with the rationale for applying the same overall limit to cash borrowing and short selling. The commenter noted that there are acute differences in these strategies with respect to hedging. This commenter proposed short selling and cash</p>	<p>Change not made. We believe the 50% of NAV short selling limits is an appropriate regulatory standard for these funds.</p> <p>Change not made. As noted previously, the aggregate limit is intended to represent an overall cap on direct borrowing. Please see our responses above concerning exempting hedging transactions from the short-selling limits.</p>

	<p>borrowing be subject to separate limits rather than aggregated within the same 50% limit and that the 50% limit on short selling exclude short selling for hedging purposes.</p>	
<p><b>Section 2.7 – Transactions in Specified Derivatives for Hedging and Non-Hedging Purposes</b></p>		
<p><i>Provisions governing use of Derivatives generally</i></p>	<p>Once commenter suggested that we reconsider our approaching to regulating investments funds’ use of derivatives to take a more principals-based approach and focus on the nature of the instrument and overall exposure and risk of a portfolio rather than strictly defined categories and labels. This commenter believes this will provide greater consistency and simplicity for investors and industry participants.</p>	<p>Change not made. This would be inconsistent with the mostly prescriptive approach taken with respect to the various investment restrictions in Part 2 of NI 81-102. We do note that there are exemptions from certain of these provisions that are tied to specific types of derivatives, such as the case with exemptions applicable to “cleared specified derivatives” which reflect exemptive relief already granted.</p> <p>However, a reconsideration of the approach to regulation of this area for investment funds is beyond the scope of this Project.</p>
<p><i>Subsection 2.7(4) Counterparty Exposure Limits</i></p>	<p>Several commenters did not agree with the proposal to no longer exempt alternative funds from the counterparty exposure limits in subsection 2.7(4). They believe it is not clear that there is any risk from exposure to a single counterparty that needs to be mitigated. They were also concerned that it may add significant operational and compliance costs.</p>	<p>We believe that some measures to mitigate counterparty risk are appropriate. The proposal to remove the exemption from this provision that had applied to commodity pools reflected our view that there was no clear basis for commodity pools or alternative funds being fully exempted from this restriction while other mutual funds were not. We have however, included exceptions to this restriction in cases where we believe the concerns about excessive counterparty exposure are sufficiently mitigated. The</p>

	<p>These commenters also suggested that any calculation of the mark-to-market value of counterparty exposure should be net of any credit support offered by a counterparty on the basis that it eliminates credit risk of the counterparty. Some of these commenters noted that such support was provided by counterparties to NRIFs that entered into prepaid forward agreements.</p> <p>Another commenter suggested counterparty exposure limits may be problematic in light of increased limits for borrowing and short-selling as it could require funds to use multiple counterparties for the same transactions which may not be efficient.</p> <p>Other commenters were in favour of an exemption from the counterparty exposure, concentration and illiquid asset limits for any fund that enters into a prepaid specified derivative transaction, provided the transaction is subject to certain conditions regarding the counterparty's obligations that would protect the fund. It believes these transactions are beneficial to investment funds as a tax deferral tool.</p> <p>Another commenter believes counterparty exposure should be measured across the board, on a net basis, and not just with respect to the use of specified derivatives.</p>	<p>Amendments now provide for an exemption where the specified derivative is a "cleared specified derivative" or where the applicable counterparty has a "designated rating".</p> <p>We are not proposing to change the method by which mark-to-market exposure under this subsection is calculated. A change of this nature would be beyond the scope of this Project.</p> <p>The counterparty exposure provisions in this section only apply with respect to transactions in specified derivatives. Counterparty exposure limits for other types of transactions are addressed elsewhere in NI 81-102.</p> <p>Change not made. We believe that a specific exemption like this could be better addressed through other means, such as an application for exemptive relief.</p> <p>Change not made. We note that specified derivatives are not the only types of transactions for which a limit on counterparty exposure is imposed, and these different limits are in place to address counterparty risk</p>
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	<p>A different commenter suggested that a counterparty with a designated rating be exempted from the counterparty exposure limits as a better balance to the CSA's goals in mitigating counterparty risk.</p> <p>Another commenter requested guidance on the interpretation of the counterparty exposure limit and asks the CSA to consider how exposure can be mitigated through collateralization rather than rigid limitations.</p>	<p>in respect of the particular type of transaction, rather than simply relying on an overall counterparty exposure limit.</p> <p>We have made this change. Please see our response above.</p> <p>The counterparty exposure limits in this section are based on a mark-to-market calculation which takes into account offsetting positions between counterparties. We also note that this part of the provision is unchanged under the Amendments, so there is no change to how it is currently applied and calculated.</p>
<p><b>Section 2.9.1 - Leverage</b></p>	<p>One commenter supported allowing an increased use of leverage by alternative mutual funds but noted that the greater restriction on the use of borrowing/short-selling vs. derivatives implies that those strategies are inherently riskier than derivatives. This could result in some managers using riskier forms of leverage with strategies that would typically require more than 50% of NAV. This commenter suggests a solution could be to consider different tiers of restrictions depending on the risk classification of the fund.</p> <p>A commenter wanted to clarify that it was not the CSA's intent for the leverage and borrowing restrictions in the Proposed Amendments to apply to conventional mutual funds, but only to alternative</p>	<p>The investment restrictions in NI 81-102 are generally not tied to any specific strategy employed by a fund. We believe this would be unduly complicated from a regulatory standpoint. There are other avenues for addressing fund or strategy-specific concerns like this, such as applying for exemptive relief, which can be better targeted to the concern being raised.</p> <p>That is correct. The proposed borrowing provisions allowing up to 50% cash borrowing, as well as the leverage restrictions in section 2.9.1 will only apply to alternative mutual funds and non-redeemable</p>

	<p>funds and NRIFs.</p> <p>Another commenter suggested a separate higher limit for fixed income funds (similar to the IIROC rules) and that further review of the proposal is warranted.</p> <p>This commenter was also in favour of excluding hedging transactions by netting off transactions involving the same instrument, same reference asset, maturity and other material terms.</p> <p>One commenter was in favour of there being no limit on leverage, as long as the leverage used is disclosed.</p> <p>Some commenters do not agree that having both individual limits on borrowing and short selling and an aggregate “3 buckets” limit on leverage will provide better protection. They note that many PMs run strategies that employ one primary form of leverage – compartmentalizing in this way may force manager to</p>	<p>investment funds. The wording in section 2.9.1 has been amended to make this clearer. The restrictions on the use of leverage by conventional mutual funds are unchanged by the Amendments.</p> <p>We are of the view that a single leverage limit, applied consistently for alternative mutual funds and non-redeemable investment funds, is the best approach for the sake of clarity and comparability.</p> <p>We have amended the leverage calculation in section 2.9.1 to allow for the deduction of specified derivatives transactions for “hedging” purposes as that term is defined in NI 81-102. We note that this is consistent with the approach to the use of specified derivatives for conventional mutual funds under sections 2.7 and 2.8 of NI 81-102.</p> <p>Change not made. We do not agree that unlimited leverage is appropriate for a retail-focused mutual fund from a risk perspective and do not believe that disclosure alone would be sufficient.</p> <p>Change not made. We believe placing a hard limit of 50% on cash borrowing and short selling is a prudent measure for introducing this form of leverage into the retail space. We also believe that, an overall leverage limit is appropriate to ensure that indirect leverage through derivatives is also appropriately managed.</p>
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	<p>use alternative forms of leverage that may not be a good fit for their strategy.</p> <p>Another commenter recommends increasing the leverage limit to 400% as it would facilitate a wider variety of strategies.</p>	<p>Change not made. We think the 3x limit is appropriate. As indicated above, the calculation methodology is being amended to allow for the deduction of derivatives transactions that are for hedging purposes.</p>
<b>Section 2.12 – Securities Loans</b>	<p>One commenter recommended we revisit the rules related to permitted collateral for securities lending to allow for the delivery of equities as this would put Canada on par with global parties that accept equities as collateral, including UCITS funds in Europe.</p>	<p>A change of this nature is not within the scope of this Project.</p>
<p><b>Part 3 – New Mutual Funds</b></p> <p><i>Seed Capital Requirements for Alternative Funds</i></p>	<p>One commenter was against the removal of the permanent seed capital requirement that applied to commodity pools under NI 81-104. This commenter believes that fund managers should be required to permanently retain capital within a fund.</p>	<p>Change not made. The proposed change will result in alternative mutual funds being subject to the same seed capital requirements as any other mutual fund subject to NI 81-102, which do not include a requirement to maintain permanent capital in the fund. We note that the seed capital requirements in NI 81-102 are designed to ensure that funds have adequate capital to launch and not as a means of ensuring fund manager prudence. Investment fund managers are required to always act in a fund’s best interest under securities law. In addition, investment fund managers are also subject to registration and to independent review committee oversight which was not the case when the commodity pool seed capital requirements were first put into place in NI 81-104.</p>
<b>Part 6 – Custodianship Of Portfolio Assets</b>		
<b>Section 6.2 -</b>	<p>A number of commenters recommended we expand the</p>	<p>A more broad-based change of this nature to the</p>

<p><b>Entities Qualified to Act as a Custodian or Sub-Custodian for Assets held in Canada.</b></p>	<p>scope of entities permitted to hold portfolio assets for alternatives funds, to include any IIROC registered dealers, rather than requiring a primary custodian for portfolio assets pursuant to section 6.2, with selected carve-outs for certain types of transactions, as this would allow prime brokers to also act as fund custodians. These commenters also noted that IIROC has robust rules for dealers holding client assets that would mitigate concerns about this.</p> <p>A different commenter suggested we ensure that an IIROC registered dealer that meets the criteria set out in subsection 6.2(3) of NI 81-102 can act as a custodian to an alternative fund.</p> <p>Another commenter sought assurance that the custodial provisions will be broad enough to allow prime brokers, including non-Canadian prime brokers, to hold portfolio assets for alternative funds.</p> <p>Another commenter expressed concern that many prime brokers may not necessarily have the intra-company infrastructure in place to meet the custodian requirements in NI 81-102 and may also not be set up to meet the review and compliance reporting</p>	<p>custody requirements in NI 81-102 is beyond the scope of this Project. We have however, removed the requirement for bank-affiliated entities that act as custodians to have financial statements that have been made public, in response to feedback this has prevented certain entities that are wholly-owned affiliates of a bank, such as their related dealers or prime brokers, from acting as custodians or sub-custodians, because they do not have separate public financial statements, which was not the intent of that provision.</p> <p>Change not made. As noted above, we are not contemplating expanding the scope of permitted custodians in this manner as part of this Project.</p> <p>If a prime broker can meet the criteria set out in sections 6.2 or 6.3 under the Amendments, it can act as an investment fund’s custodian. The provisions are not intended to specifically apply to or exclude those entities. We also note that the custodial provisions governing specific types of transactions such as borrowing, short selling, securities lending or use of specified derivatives in section 6.8 and 6.8.1 are broad enough to contemplate entities other than the fund’s main custodian, including prime brokers, holding fund assets to facilitate those types of transactions.</p> <p>Change not made. We do not believe there is a policy basis for exempting prime brokers from the review and compliance reporting requirements that are intended to apply to any entity that acts as an investment fund’s custodian. We note that many of these requirements do</p>
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	<p>requirements. This commenter asked that prime brokers be specifically exempt from meeting those requirements. They noted that if alternative funds are required to have a custodian in addition to a prime broker, it could impose additional costs in respect of establishing new operational infrastructure which may deter some firms from creating products in the NI 81-102 space.</p>	<p>not apply in respect of the custody provisions governing the transactions referred to in sections 6.8 and 6.8.1 which are they types of transactions for which prime brokers are often employed.</p>
<p><b>Section 6.8 - Custodial Provisions relating to Borrowing, Derivatives, Securities Lending Repurchase and Reverse Repurchase Agreements</b></p> <p><i>Codification of “Cleared OTC Derivatives” Relief</i></p>	<p>One commenter expressed support for the proposal to codify in NI 81-102 exemptive relief to facilitate funds investing in OTC derivatives that are cleared in accordance with the provision of the “Dodd-Frank” legislation in the US, and similar provisions in Europe. However, this commenter suggested amendments to the custodian requirements in section 6.8 of NI 81-102 to better reflect the terms of the relief. This commenter suggested we amend subsection 6.8(1) to specifically contemplate banks, as they are typically the counterparties to derivatives transactions in Canada, and a change to subsection 6.8(2) to adopt the “regulated clearing agency” language in National Instrument 94-101 <i>Mandatory Central Counterparty Clearing of Derivatives (NI 94-101)</i>.</p>	<p>While we have not made the specific amendments mentioned in the comment, we have made changes to the applicable provisions to better reflect the terms of the exemptive relief they are based on.</p>
<p><b>Section 6.8.1 - Custodial Provisions Relating to Short Selling.</b></p>	<p>A number of commenters pointed out a technical issue with the short-selling custodial provisions in section 6.8.1. They noted that section 6.8.1 restricts deposits with a single sub-custodian for short sales to no more than 10% of NAV. However, with the proposed 50% short selling limit, this could require an alternative fund to have several different borrowing agents in order to take advantage of the higher limit, which may not be</p>	<p>We have amended the applicable provisions to allow an alternative mutual fund or NRIF’s to deposit up to 25% of its net assets with a single counterparty for short selling transactions, to better align with the increase in overall short-selling to 50% of NAV permitted for alternative mutual funds and NRIFs under the Amendments.</p>

	<p>operationally efficient for the fund. A number of these commenters recommended solutions to this issue.</p> <p>Other commenters recommended increasing the limit with any one borrowing agent to 20%, as it would strike a balance between efficiently executing strategies and alleviating potential counterparty risk.</p> <p>One commenter recommended increasing the deposit limit to 25% to allow funds to use only two agents rather than five or more under the current proposal.</p> <p>Another commenter recommended an exemption from the 10% deposit limit for prime brokers.</p> <p>A different commenter recommended that we allow funds to simply deposit sufficient collateral with the prime broker/borrowing agent against such borrowing or short selling based on the current regulatory margin rates for IROC broker dealers and that proceeds from short sales be included as eligible margin for that purpose.</p>	<p>We are changing the limit to 25%. Please see the response above.</p> <p>Change made. Please see the response above.</p> <p>Change not made. Please see the response above.</p> <p>Change not made. Please see the response above.</p>
<p><b><i>Rehypothecation of Collateral</i></b></p>	<p>One commenter suggested that the CSA specifically permit rehypothecation of collateral pledged by a fund for borrowing, short selling or derivatives as this could result in lower fees for funds. This commenter noted that IROC rules permit this for unsegregated client assets held with a dealer.</p>	<p>Change not made. The CSA's view regarding rehypothecation by a counterparty of collateral pledged by an investment fund has not changed in connection with this Project.</p>

	<p>Another commenter asked for clarification of recent OSC guidance regarding hypothecation of collateral pledged with a counterparty, borrowing agent or sub-custodian.in these circumstances.</p>	<p>This request is beyond the scope of this Project.</p>
<p><b>Part 7 – Performance Fees</b></p>	<p>One commenter told us it believes fee disclosure, particularly of performance fees must be very clear. This commenter notes that alternative funds can charge performance fees on a total return up to a certain high water mark and that private funds will often reset the high water mark on a regular basis, but that there is no provision to do so under the Proposed Amendments.</p> <p>Another commenter wants the CSA to provide a definition of “high water mark” and to test the disclosure of performance fees with investors to ensure the description is understood.</p>	<p>We agree and note that alternative mutual funds will be required to fully disclose the terms of any performance fees arrangements, consistent with current disclosure requirements for other investment funds.</p> <p>We note that the term “high water mark” is not used anywhere in this section, in regard to performance fees. Therefore defining it is unnecessary. We also note that these provisions are replacing the same requirement applicable to commodity pools under NI 81-104.</p>
<p><b>Part 9 – Sale Of Securities Of An Investment Fund</b></p> <p><b>Part 10 - Redemption Of Securities Of An Investment Fund</b></p>	<p>Several commenters noted a technical issue regarding a discrepancy in the regime for purchase and redemptions for alternative funds. This issue is with the provisions that require a daily NAV calculation under 81-106 versus purchase/redemption requirements in Parts 9 and 10 of NI 81-102 that mandate which NAV must be used for purchases and redemptions. These commenters noted that this can pose a problem for alternative funds that do not accept daily redemptions.</p> <p>One of the commenters suggested amending the relevant provisions in Parts 9 and 10 to allow alternative funds that do not offer daily redemptions to</p>	<p>Change not made. This is a requirement applicable to all mutual funds and is not specific to alternative mutual funds. Mutual funds are not required to offer daily purchases or redemptions. As such it is not clear to us that a modification to these provisions specific to alternative mutual funds is necessary and that fund manufacturers can find solutions within the scope of these provisions to address these concerns.</p>

	<p>have more flexibility to accept purchases or pay redemptions. Specifically, the commenter suggests allowing these funds to pay redemptions or accept purchases based on the NAV determined as of the fund's next purchase or redemption date, instead of the most recent NAV calculated within a prescribed time period after receipt of the purchase/redemption order, as is currently required. The commenter added this would better address the concern than the wording under the currently proposed subsection 10.3(5) of NI 81-102.</p>	
<p><b>Part 15 – Sales Communications And Prohibited Representations</b></p>		
<p><b>Section 15.6 – Performance Data – General Requirements</b></p>	<p>Several commenters asked that we give a limited exemption from the provisions regarding the use of historical performance data to permit existing pooled funds that may convert to alternative funds under NI 81-102 to be able to use their historical performance data prior to conversion in sales communications, with appropriate qualifications. Some expressed concern that without this data, investors will not have a full picture of a manager's skill set.</p>	<p>Change not made. We note that the restriction is in place in part because funds sold in the exempt market are not subject to the same investment restrictions as funds under NI 81-102 and therefore are able to use strategies not available to funds under NI 81-102. Any disclosure of performance history on this basis can be misleading to investors.</p>
<p><b>Marketing Materials</b></p>	<p>One commenter recommended we provide additional guidance expanding on previous guidance regarding the use of marketing materials by alternative funds</p>	<p>We note that the guidance on the use of marketing materials in Part 15 applies to all mutual funds including alternative mutual funds.</p>

	<p>including guidance on appropriate classification, and how products/strategies will be used by portfolio managers in certain market conditions.</p> <p>Another commenter wants the CSA to review the marketing requirements for investment funds and determine whether the rules need revision or strengthening and wants better enforcement of existing sales practice rules.</p>	<p>This request is beyond the scope of this Project.</p>
<p><b>National Instrument 81-104 <i>Commodity Pools</i></b></p>		
<p><b>Part 4 - Proficiency And Supervisory Requirements</b></p>	<p>There was support for our proposal to repeal the proficiency requirements for mutual fund dealers dealing in commodity pools from Part 4 of NI 81-104, and to engage with the Mutual Fund Dealers Association (MFDA) regarding reviewing how existing proficiency requirements may need to be reconsidered in respect alternative funds.</p> <p>A number of these commenters added that they do not believe that the Proposed Amendments for alternative funds represent a significant departure from conventional mutual funds in terms of complexity, in that many of the same strategies can be employed by both types of products – the difference relates primarily to the extent these strategies can be used. They recommend we take a principles-based approach to any additional proficiency requirements, consistent with general registrant proficiency requirements in National</p>	<p>We have reconsidered our initial proposal on mutual fund dealer proficiency for alternative mutual funds and decided to retain those provisions within NI 81-104. We recognize that any consideration of revisions to these proficiency standards should be conducted as part of a larger review of overall dealer proficiency requirements which would be beyond the scope of this Project.</p> <p>Please see our response above.</p>

	<p>Instrument 31-103 <i>Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)</i>.</p> <p>A different commenter suggested the proficiency for selling alternative funds should be the same as for selling hedge funds as they are equally complex.</p> <p>One commenter expressed concern that any proposed changes in proficiency requirements not create increased confusion or burden for investors, noting that in some cases, an investor may have to deal with multiple dealers in the same firm with respect to different investment funds in their account with that firm.</p> <p>Others agreed that proficiency is best dealt with through the MFDA. These commenters added that the current proficiency requirements under NI 81-104 have been a significant impediment to distribution by mutual fund dealers and that establishing unnecessarily strict proficiency requirements again would result in the same issue.</p> <p>One commenter recommended specific proficiency requirements for trading in alternative funds. It added that if the CSA decides to raise the base level for mutual fund dealers then it should recommend a refresher course for all existing dealers as well to level the playing field. This commenter suggests that any additional proficiency courses and content be validated</p>	<p>Please see our response above.</p> <p>Please see our response above.</p> <p>Please see our response above.</p> <p>Please see our response above. We welcome any input in this area.</p>
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	<p>in collaboration with the MFDA, the CSA and any applicable proficiency course providers to ensure consistency and has offered to participate in that process.</p> <p>Two commenters expressed concern that similar issues that have arisen in the past with the mis-selling of certain products by dealers due to inadequate training can occur again with alternative funds. They believe specific training is required for dealing representatives with evidence of successful completion of the training being retained in personnel records. These commenters added that deficiencies in the “know your client” process could be harmful for investors investing in alternative funds. They also believe that the current suitability standard is inadequate and that a fiduciary or “best interest” standard should be applied to dealers. They added that they do not expect these products to be sold on a “DSC” basis. They also took note of the concurrent work the CSA is engaged in regarding the relationship between dealers and clients, notably under <i>CSA Consultation Paper 33-404</i> which may address some of these concerns.</p>	<p>The concerns are noted. Please see our response above regarding the mutual fund dealer proficiency standards for alternative mutual funds.</p> <p>As the commenter notes, the CSA is currently working on initiatives that are intended to address some of these concerns and issues.</p>
<p><b>NI 81-106 – <i>Investment Fund Continuous Disclosure</i></b></p>		
<p><b>Part 3 – Financial Disclosure Requirements</b></p>	<p>Some commenters expressed concern with what they see as limited guidance on the inclusion of short selling/borrowing expenses in the calculation of an alternative fund’s management expense ratio (<b>MER</b>) or trading expense ratio (<b>TER</b>). The concern is with the</p>	<p>We note that funds have been permitted to engage in these activities for several years already and therefore have already been providing this disclosure in their financial statements. It’s not clear to us how the Amendments would be the cause for any particular</p>

	<p>inconsistency in how amounts are applied which can result in less comparability. These commenters added their view that these expenses should be more properly characterized as TER.</p> <p>One of the commenters also stated that some clarification of the potential impacts of the Proposed Amendments on existing MRFP disclosure requirements would be helpful, in particular relating to TER and total return calculations. They also suggested that commentary on the treatment of costs related to short sale transactions would be beneficial to ensure consistency.</p> <p>Some of these commenters added that the requirement to bifurcate returns for long and short position should be removed for alternative funds as it could be misleading in terms of understanding an alternative fund's strategies.</p>	<p>confusion on these issues. As such we think this is a question that may be better addressed outside of the purview of this Project.</p> <p>We note that this isn't a new requirement – commodity pools have been required to provide this disclosure under NI 81-104 for a number of years. It is simply being migrated to NI 81-106. As such it is not clear what particular impact to the MRFP this comment is concerned about.</p> <p>Change not made. All mutual funds already have the ability to sell securities short, so it is not clear why different reporting requirements should apply to alternative mutual funds relative to other mutual funds in this regard.</p>
<p><b>Part 14 – Calculation Of Net Asset Value</b></p>	<p>One commenter believes that the operational demands and costs for an alternative fund manager to provide daily NAV calculation as a result of using derivatives is not justified nor is such frequency likely to be demanded by investors. This commenter recommends that NI 81-106 be updated to permit alternative funds to calculate NAV on up to a monthly basis.</p> <p>A different commenter expressed a similar concern about the requirement to provide a daily NAV. This commenter suggested amending the definition of</p>	<p>Change not made. This requirement applies to all publicly-offered investment funds, many of which use derivatives. We don't believe alternative mutual funds should be treated differently in this regard.</p> <p>Change not made. Please see above.</p>

	“specified derivative” in NI 81-102 to exclude derivatives used for hedging purposes as this would allow funds that only use derivatives for hedging purposes to calculate a NAV once a week instead of daily.	
<b>NI 81-107 – <i>Independent Review Committee For Investment Funds</i></b>		
<b><i>Applicability to Alternative Funds</i></b>	One commenter questioned whether the provisions of NI 81-107 will be adequate for alternative funds and suggests this may require considerable analysis and reflection.	NI 81-107 applies to any publicly-offered investment fund, which includes commodity pools and NRIFs. We do not believe that alternative mutual funds will create any unique issues within this Instrument.
<b>Other Comments</b>		
<b><i>Impact of exempt market dealer amendments on alternative funds</i></b>	One commenter reiterated comments they had previously provided in respect of then proposed amendments to NI 31-103 and OSC Rule 33-506 ( <i>Commodity Futures Act</i> ) <i>Registration Information</i> , regarding changes to the exempt market dealer requirements. This commenter expressed concern that if the Proposed Amendments come into force, the exempt market dealer changes could result in those dealers being prohibited from distributing alternative strategies in the retail space that it can distribute in the exempt market.	We thank the commenter for this comment but note that it refers to matters that are beyond the scope of this Project.

**Part III - COMMENTS IN RESPONSE TO CONSULTATION QUESTIONS**

<p><b>1. Under the Proposed Amendments, we are seeking to replace the term “commodity pool” with “alternative fund” in NI 81-102. We seek feedback on whether the term “alternative fund” best reflects the funds that are to be subject to the Proposed Amendments. If not, please propose other terms that may better reflect these types of funds. For examples, would the term “non-conventional mutual fund” better reflect these types of funds?</b></p>	
<u>Comments</u>	<u>Responses</u>
<p>Most commenters agreed with using the term “alternative fund” as being a more accurate term than “commodity pool”. Some suggested slight modifications to the definition to better clarify operational differences from other mutual funds.</p> <p>Some commenters weren’t as comfortable with the term “alternative fund” to describe these products. They noted that the term is already in common use in the marketplace, and generally refers to hedge funds sold under a prospectus exemption.</p> <p>Some of these commenters questioned why the proposed definition refers only to a type of mutual fund or why we are proposing to integrate that term in NI 81-102.</p> <p>Another of the commenters suggested a preference for the term “alternative mutual fund”, which they believe is more consistent with language used in other jurisdictions.</p> <p>Some other commenters noted that there are publicly-offered</p>	<p>We have changed the defined term to “alternative mutual fund” to make it clearer that these products will be mutual funds and have amended the wording of the definition to better clarify those operational differences.</p> <p>We have amended the defined term to “alternative mutual fund”, to better distinguish these products from hedge funds.</p> <p>The regime for alternative mutual funds is largely derived from the current regime for commodity pools, which are defined as mutual funds. The term is being integrated into NI 81-102 as part of the migration of the current NI 81-104 requirements in that rule.</p> <p>Change made. Please see our responses above.</p> <p>We agree. While we are not prescribing a naming convention for</p>

funds in the marketplace that use the term “alternative” or “liquid alternative” in their names and recommended the CSA provide guidance in the CP to NI 81-102 on whether those funds would have to become alternative funds or remove that term from their names to avoid confusion.

A different commenter was not in favour of referring to existing NI 81-102 mutual funds as “conventional mutual funds” as it may stigmatize alternative funds by comparison, although this commenter did note that was not being proposed under the Proposed Amendments. This commenter is of the view that the terms “mutual fund”, “alternative fund” and “non-redeemable investment fund” are sufficient differentiators.

One commenter suggested that there is a risk that the term “alternative fund” could result in investors believing the fund only invests in alternative asset classes like real estate or infrastructure and suggested a term like “Alpha funds” may be more appropriate.

Another commenter doesn’t think the term “non-conventional mutual fund” is appropriate for these products as it pre-supposes that investors would understand and appreciate what are

alternative mutual funds, it is our expectation that only mutual funds that are “alternative mutual funds” as defined in the Amendments will use the term “alternative” in either their name or description. It could otherwise be misleading to investors. We have provided guidance in the CP to NI 81-102 to clarify the CSA’s views on this.

We agree and thank the commenter for the support.

Alternative mutual funds will be required to disclose the types of assets they are permitted to invest in, in accordance with their investment objectives and regulatory restrictions, as is the case with other investment funds subject to NI 81-102. As well, NI 81-102 will generally prohibit alternative mutual funds from investing in these types of assets. Investors will also have the ability to speak to their advisor or dealer about these products to clarify that they do not invest in these types of assets. We further note that alternative mutual funds will not be required to use the word “alternative” in their names. The term “alternative mutual fund” is a definition for regulatory purposes, so we don’t believe there is a significant risk of confusion on that basis.

We agree.

<p>“conventional” investment strategies for investment funds.</p> <p>One commenter recognized the need to adopt legal definitions for the purposes of distinguishing amongst categories and is fine with the proposed term “alternative fund” so long as it is not accompanied by a naming or labelling requirement.</p> <p>A different commenter preferred that the term “alternative fund” be used solely as a descriptive term and not as a defined term.</p>	<p>We are not proposing a naming convention for alternative mutual funds.</p> <p>Alternative mutual funds are a separate category of mutual fund with different investment restrictions than other mutual funds. A definition is therefore necessary in order to properly distinguish these mutual funds from other mutual funds for regulatory and disclosure purposes.</p>
<p><b>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 Proposed Amendments, that we should be considering, and why.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Responses</u></b></p>
<p>Several commenters felt that most asset classes typically associated with liquid alternative strategies are contemplated in the Proposed Amendments.</p> <p>Other comments specifically highlighted “market neutral” strategies as one in which the Proposed Amendments may be problematic in that that proposed short selling restrictions may not allow for the most efficient implementation of that strategy.</p> <p>Other commenters suggested that private loans/debt, (without regard to administrative responsibilities), real estate/real property and mortgages (whether guaranteed or not), as examples of typical “alternative” asset classes that should be contemplated for</p>	<p>We thank the commenters for their support.</p> <p>We are of the view that there are other avenues for better addressing concerns with the impact on specific fund strategies like this outside of rule-making.</p> <p>Change not made. The CSA’s view generally is that owning or managing real estate assets or administering loans is not consistent with being an investment fund as defined in securities legislation. As well, we note that the prohibition on investing in</p>

<p>investment by alternative funds.</p> <p>A different commenter noted that the categories of “alternative investment strategies” is always changing, though given the need for frequent redemptions at NAV, they expected that only commodity pools and certain hedge fund strategies will be able to utilize the Proposed Amendments.</p> <p>This commenter also recommended the applicable investment restrictions on NRIFs be returned to their pre-2014 levels.</p>	<p>non-guaranteed mortgages was extended to all publicly offered investment funds in connection with the “Phase 2” amendments to NI 81-102 published in 2013. This reflected the CSA’s view that these products may not be appropriate investments for publicly offered investment funds, and that position has not changed in connection with this Project.</p> <p>We recognize that not every alternative strategy in the hedge fund space can be adapted to fit within the Amendments for the alternative mutual funds regime, and it is not the intent of the Project to facilitate that.</p> <p>Change not made. For the reasons articulated previously in the earlier phases of the Modernization Project, we think the investment restrictions for NRIFs set out in the Amendments are appropriate for publicly-offered investment funds. We note however, that the transition provisions will allow for some grandfathering for pre-existing NRIFs.</p>
<p><b>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 centration, 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 NI 81-102? Please explain why or why not.</b></p>	
<p style="text-align: center;"><u>Comments</u></p>	<p style="text-align: center;"><u>Response</u></p>
<p>Many commenters supported the proposed 20% of NAV concentration limit for alternative funds, but do not believe a “hard cap” limit is necessary. These commenters cited concerns that a hard cap could result in forced sales of assets which may not be in a fund’s best interest.</p>	<p>We are not proposing a hard cap on the concentration limits for alternative mutual funds.</p>

One commenter suggested that this proposed new limit be extended to more conventional mutual funds as well.

Another commenter added that we should consider allowing greater flexibility in the concentration limits for funds that track an index.

One of the commenters noted that while it may be the case that a majority of NRIFs already abide by a lower concentration limit, they don't believe it is necessary to codify this and suggested a broader fixed portfolio exemption than is contemplated, that would essentially exempt any proposed fund that adopts a "rules based" or formulaic approach to investing.

Another commenter stated that some investors may find more concentrated positions more appealing in an alternative fund or NRIF as they will often focus on diversity at a portfolio not a fund level.

One commenter recommended that the CSA consider whether conventional concentration limits are appropriate and in particular whether timely disclosure in the investment strategies and Management Discussion and Analysis of an alternative fund would be preferable to a hard cap. This commenter added that if a hard cap is imposed, that there be a reasonable transition period and readily available exemptive relief for existing funds.

Change not made. We do not believe a higher concentration limit would be appropriate for more conventional mutual funds.

Subsection 2.1(2) of NI 81-102 already provides an exemption from the concentration restrictions for funds that track an index. That provision is not being changed under the Amendments.

We have replaced the defined term "fixed portfolio ETFs" with "fixed portfolio investment fund" which extends the exemption to NRIFs that employ a similar structure. We also note that the exemption for funds that track an index remains intact. We are not in favour of introducing any further carve-outs from this restriction in the Instrument at this time.

We note that the concentration restrictions for alternative mutual funds will be double the limit applicable to more conventional mutual funds.

We are not imposing a hard cap on the concentration restriction. The 20% limit will be a "time of purchase" test, in line with how the restriction for conventional mutual funds is applied.

<p>A different commenter advocated for aligning the CSA rules with the rules applicable to European UCITS, which allow for higher concentration limits for investments in government/supranational assets and the like. This commenter also suggests this limit also include mark-to-market exposure of OTC derivatives, and believes that the concentration limit apply on an ongoing basis and not just at the time of purchase, with a plan to reduce exposure if the limit is passively exceeded.</p>	<p>Subsection 2.1(2) of NI 81-102 already provides for an exemption from the concentration for investments in “government securities”, which are generally defined as those issued by the Government of Canada or a province/territory, or the Government of the United States. The Companion Policy to NI 81-102 also discusses that the CSA will consider exemptive relief to permit a higher concentration limit for investment in securities issued by foreign governments or supranational agencies that meet certain minimum credit rating criteria. That relief has been granted numerous times in the past. We also note that the concentration limits in section 2.1 of NI 81-102 include a “look-through” test in regards to derivatives or underlying funds held by a fund. These provisions will remain unchanged under the Amendments.</p>
<p>One commenter stated that concentration risk in isolation is not informative and may oversimplify the risk associated with additional asset classes under the proposal. As a result, this commenter does not agree with increasing the concentration limit for alternative funds, and alternatively proposes a limit in which no more than 50% of a fund’s NAV can comprise holdings that individually exceed 10% of fund’s NAV. This commenter also does not support a hard cap as it could result in a forced sale under distressed conditions.</p>	<p>Change not made. The approach to the concentration limit for alternative mutual funds and NRIFs is intended to be consistent with the approach taken for other mutual funds under NI 81-102, which are “time of purchase” limits and do not include a hard cap.</p>
<p>Another commenter believes that control limits should be similarly increased along with concentration limits. This commenter noted that it is not inconsistent from a practical standpoint, with several funds from the same manager having significant holdings of the same issuer.</p>	<p>Change not made. We do not agree that permitting mutual funds to hold a higher proportion of an issuer’s securities is comparable to allowing a higher proportion of a fund’s portfolio to be invested in an issuer. We note that the purpose of the control restrictions in section 2.2 in part is to avoid conflict with take-over bid legislation</p>

**4. We are not proposing to raise the illiquid asset limits for alternative funds under the Proposed Amendments. Are there**

<b>strategies commonly used by alternative funds for which a higher illiquid asset investment threshold would be appropriate? Please be specific.</b>	
<b><u>Comments</u></b>	<b><u>Responses</u></b>
<p>Several commenters suggested we increase the limit to 15% of NAV at the time of purchase with 20% hard cap.</p> <p>These commenters also suggested we amend the definition of “illiquid asset” in conjunction with the increased limit. These commenters suggested the definition either explicitly contemplate OTC transactions without references to “market facilities” or “public quotations”, or that we adopt an approach similar to the SEC in the United States, where the definition is linked to how quickly an asset can be disposed of at its market value.</p> <p>Another commenter suggested we increase the limit to match the proposed limit for NRIFs. This commenter noted that alternative funds are intended to have greater flexibility to pursue different strategies than mutual funds and having a higher illiquid asset limit would help provide this.</p> <p>Some commenters stated investment in distressed securities, loans, real property and non-guaranteed mortgages, as well as arbitrage</p>	<p>Change not made. These Amendments are intended to facilitate alternative strategies for funds that will retain similar structural and liquidity characteristics to more conventional mutual funds. Accordingly, we favour the same illiquid asset limits for alternative mutual funds as for other mutual funds.</p> <p>As we have noted previously, amending the definition of “illiquid asset” in this manner is beyond the scope of the Project.</p> <p>Change not made. As noted above, we expect alternative mutual funds will be structurally similar to other mutual funds and likely have similar redemption policies. The higher illiquid asset limit for NRIFs is recognition of the difference in fund structure and means of securityholder liquidity for NRIFs compared to mutual funds. NRIFs tend to offer limited redemption rights (if any) and their securities are primarily traded over an exchange. Therefore, it is our view that these funds can manage a higher illiquid asset limit than mutual funds.</p> <p>Please see our earlier response above in regards to publicly-offered investment funds investing in these types of assets.</p>

<p>strategies are examples of strategies in which a higher illiquid asset limit might be more appropriate as the intent is to capture the illiquidity premium.</p> <p>Other commenters told us that we should consider allowing alternative funds to invest a portion of their assets in pooled funds in order to give greater access to less liquid alternative strategies without creating greater risk as retail investors may benefit from some access to these types of investments.</p> <p>Another commenter agreed that there should not be a higher illiquid asset limit for alternative funds, as there is no reason to believe the liquidity needs for alternative funds are different than for other mutual funds. This commenter added that the limits are necessary for products that offer daily liquidity.</p>	<p>Change not made. The proposed fund of fund restrictions in NI 81-102 for alternative mutual funds are in part designed to limit the ability of a fund to indirectly invest in assets or access strategies they cannot invest in directly. Pooled funds are not subject to any of the investment restrictions in NI 81-102, therefore it would be inconsistent with the intent of the fund of fund provisions to allow alternative mutual funds to invest in pooled funds in the manner contemplated.</p> <p>We agree and thank the commenter for the support.</p>
<p><b>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.</b></p>	
<p style="text-align: center;"><u><b>Comments</b></u></p>	<p style="text-align: center;"><u><b>Responses</b></u></p>
<p>Most commenters agreed that we should take redemption frequency into account in considering an illiquid asset for alternative funds – specifically, a higher limit for funds with less frequent redemptions, and lower limits for more frequent redemptions.</p>	<p>Change not made. We have determined that crafting illiquid asset restrictions in this manner would be unduly complex and impractical from a rule-making perspective. There may be better avenues for considering a more flexible approach like this depending on the particulars of the applicable fund or strategy. Managers should also be considering their liquidity needs as part of their duty of care to their investment funds.</p>

One of the commenters added that alternative funds should be permitted to pursue strategies that involve investing in a greater proportion of illiquid assets as long as the manager has policies and procedures to manage liquidity risk and that this is disclosed to investors. This commenter also suggested we allow greater flexibility for longer notice periods for withdrawals or for the ability of managers to suspend redemptions.

One commenter suggested that only funds that utilize more “liquid alternative” strategies will likely be able to safely access the restrictions under the Amendments. This commenter expressed concern that if a higher illiquid asset limit were tied to less frequent redemption rights, it could encourage the use of more illiquid strategies which could pose other unforeseen challenges around performance benchmarking, which could impact disclosure and the use of standard deviation as a risk methodology, as well as possibly under the *Income Tax Act*, which has requirements for mutual funds to offer redemptions on demand. This commenter recommended that we use a single definition for “redemption on demand” for all types of mutual funds.

Another commenter suggested that the illiquid asset limit be based on the type of asset, with a higher proposed limit of 20% of NAV with a 25% hard cap for listed illiquid securities, and the existing limits in place for unlisted illiquid securities or restricted

Change not made. We believe a prescribed limit on illiquid assets is appropriate for alternative mutual funds given that they are expected to be liquid investments with regular redemptions. We note that this approach is consistent with other international jurisdictions regarding publicly offered mutual funds. We also note, however, that Part 10 of NI 81-102 includes provisions that allow for the suspension of redemptions in certain circumstances and the Amendments will include provisions specific to alternative mutual funds that will allow for some additional flexibility on redemption policies. Nonetheless, we do encourage manager-driven initiatives in developing policies and procedures to manage liquidity risks within this regulatory framework.

We agree that a single limit on illiquid assets for all alternative mutual funds is the best approach in this case and is consistent with how this limit is applied to other types of investment funds. We do not prescribe or mandate a particular redemption frequency for mutual funds but note that Part 10 of NI 81-102 does prescribe requirements for when redemption proceeds must be paid upon receipt of a redemption request by a fund.

Similar to our responses above, we think it would be unduly complicated and impractical to attempt to craft an illiquid asset limit that varies by asset type. There may be other avenues in which more fund or strategy specific restrictions can be

securities.	considered, such as applying for exemptive relief.
<p><b>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 the 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 NI 81-106) or “pooled MIEs” (as that term was defined in CSA Staff Notice 31-323 <i>Guidance Relating to the Registration Obligations of Mortgage Investment Entities</i>).</b></p>	
<u><b>Comments</b></u>	<u><b>Response</b></u>
<p>Several commenters told us they believe it should be left to the manager, fund sponsor and underwriters of a NRIF to determine an appropriate illiquid asset limit to manage the fund’s liquidity needs and that such a limit should not be prescribed under NI 81-102.</p> <p>Another commenter told us the proposed illiquid asset limit for NRIFs should be higher than what is being proposed.</p> <p>One of the commenters expressed concern that limit could impact Flow-Throw funds as their holdings are typically initially subject to a hold period which would make those assets illiquid until the applicable hold period is completed.</p>	<p>Change not made. Many if not most NRIFs now offer some kind of redemption rights – in some cases, multiple redemption rights per year. Therefore a limit on illiquid assets is appropriate, much like with mutual funds. As noted previously, the higher limit relative to mutual funds is recognition of an NRIFs different business model, and mode of providing liquidity to investors.</p> <p>Change not made. We believe the limit is appropriate for a retail focused product and note that many NRIFs in the market already follow comparable illiquid asset limits on their own.</p> <p>We have decided not to change the illiquid asset limit for NRIF that was proposed under the Proposed Amendments. We recognize that there could be certain strategies that are impacted by this but we ultimately decided that a single illiquid asset limit for NRIFs is the most practical approach from a rule-making standpoint and is consistent with our approach to other investment restrictions in NI 81-102. We note that there may be</p>

<p>There was also concern expressed about the impact on Labour Sponsored or Venture Capital Funds. One commenter noted that many of these funds are exempted from a number of the investment restrictions under NI 81-102 and sought assurances that they would not be impacted by the Proposed Amendments, particularly in respect of concentration and investment in illiquid assets, or that at a minimum, these funds would be grandfathered from the Proposed Amendments.</p>	<p>other avenues for addressing these kinds of fund or strategy specific concerns such as applying for exemptive relief.</p> <p>These products are already exempted from a number of the investment restrictions in NI 81-102 either by way of that Instrument or their own governing legislation. We are not making any changes to those exemptions, and therefore do not expect the Amendments to impact these funds.</p>
<p><b>7. Although non-redeemable investment funds 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.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>Several commenters told us that they believe that any NRIF or alternative fund with limited or no redemption rights should have no prescribed illiquid asset limit as liquidity is not relevant for those kinds of funds, and they should be left to manage their own liquidity needs.</p>	<p>We do not agree that this is the case. As noted above, we anticipate the alternative mutual funds under this Project to have similar liquidity characteristics as other mutual funds, and other regular redemptions at NAV, consistent with other retail-focused mutual funds. We note that this approach is also consistent with fund liquidity management in many jurisdictions. We further note that since most closed-end funds also have some form of redemption rights, we believe a general illiquid asset restriction, although one that does recognize the structural differences in these products is also appropriate. We do recognize that there may be other avenues for considering more fund or strategy specific strategies than through rule-making, such as applying for exemptive relief, and that these may be more appropriate avenues for considering questions like this in certain circumstances.</p>

<p>One of these commenters added that if a limit is deemed necessary in that circumstance it would recommend a limit of 25% of NAV, introduced 6 months before the NRIF’s expected termination date.</p> <p>Another commenter does not agree with allowing a higher illiquid asset limit in that circumstance as it might inadvertently encourage or result in the offering of additional products that do not have a redemption feature, which may not be appropriate for retail investors.</p>	<p>Change not made. We do not believe that it is practical to craft an illiquid asset restriction in this manner from a rule-making perspective.</p> <p>We thank the commenter for this comment. We are not changing the proposed illiquid asset limits NRIFs.</p>
<p><b>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 borrowing for investment funds? If so, please explain why.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>There was general agreement that funds should be permitted to borrow from a broader range of entities than is contemplated under the Proposed Amendments.</p> <p>Some of these commenters recommended we expand the scope of acceptable Canadian lenders to also include any non-bank dealers that are members of IIROC, which they noted is a similar approach to that taken regarding the definition of “Canadian custodian” under (then) proposed amendments to NI 31-103.</p> <p>A number of these commenters also recommended the CSA consider allowing funds to borrow cash from entities that meet the definition of a sub-custodian for assets held outside of Canada, under section 6.3 of NI 81-102.</p>	<p>We have expanded the scope of permitted lenders to include entities that would qualify as foreign subcustodians under section 6.3 of NI 81-102, which includes foreign banks, trust companies and certain affiliates.</p> <p>Change not made. We note that the custody amendments to NI 31-103 specifically exclude funds subject to NI 81-102 as recognition of the differences between funds distributed in the exempt space and those in the retail space. As noted above, however, we have expanded the scope of permitted lenders for the purposes of the borrowing provisions in subsection 2.6(2).</p> <p>Change made. Please see our response above.</p>

These commenters also suggested the CSA should permit borrowing from non-Canadian prime brokers provided any such entity is subject to prudential supervision or other regulatory oversight in their home jurisdiction.

One of the commenters noted in particular that permitting funds to borrow from non-Canadian lenders would allow for greater efficiencies relating to loans in foreign currencies.

Several commenters also had suggestions in the event the CSA decided against expanding the scope of acceptable lenders to any entity that qualifies as a sub-custodian under section 6.3 of NI 81-102:

- One commenter suggested that we limit the scope to US lenders that meet the section 6.3 criteria.
- Another commenter suggested geographically narrowing the scope to entities organized and regulated within the European Economic Area (EEA), G7, and Australia and New Zealand.
- Another commenter suggested simply limiting funds to borrowing from a “credit institution” authorized in any of: Canada, the EEA, any signature state to the Basel Capital Convergence Agreement of July 1998, Australia, New Zealand or any other G7 country.

A number of commenters noted an issue with the custodian requirements under section 6.2(3) and 6.3(3) of NI 81-102, namely that many bank dealer affiliates are wholly-owned and don’t have public financial statements as is required under that section, even if they meet the other criteria. These commenters suggested an

Please see our response above. The changes to this provision would allow non-Canadian prime brokers to act as lenders provided certain conditions are met.

Change made. Please see our response above.

Please see our response above concerning the changes to the scope of permitted lenders.

We have amended sections 6.2 and 6.3 to make that change. Please see our responses above.

<p>amendment to require only the minimum equity threshold be met without the need for public financial statements and noted this is similar to the approach taken in recent proposed amendments to the definition of “Canadian custodian” in NI 31-103. The concern was that absent this fix, many dealers who act as prime brokers would be excluded from lending cash to funds under the Proposed Amendments.</p> <p>One commenter suggested we also consider permitting interfund borrowing as is permitted in the US and other countries.</p> <p>Another commenter was of the view that there is no need to change the proposals to expand the range of permitted lenders for alternative funds or NRIFs beyond what is proposed.</p>	<p>Change not made. We note that investment funds are currently prohibited from lending cash under NI 81-102 and we are not contemplating any change to this restriction for alternative mutual funds.</p> <p>We believe the proposed change will allow for a wider range of potential lenders, thereby allowing for more competitive pricing for funds, without increasing the risk to a fund. These funds will still be restricted to borrowing cash only from entities (or certain affiliates of those entities) that are qualified to act as a fund’s custodian or sub-custodian under NI 81-102.</p>
<p><b>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.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>Some commenters noted that the current restrictions applicable to commodity pools and NRIFs don’t set a limit on leverage through derivatives – this change could impact some commodity pools and NRIFs in the marketplace.</p>	<p>We recognize that the leverage limit could impact certain strategies currently employed by existing funds. However, in light of some of the investment flexibility being introduced under the Amendments, including the ability to borrow cash and more flexibility on short-selling, we believe it is appropriate to curtail the amount of leverage that can be generated through specified derivatives in exchange.</p>

<p>A number of commenters told us that for absolute return funds or fixed income/credit-based funds, the proposed leverage limit will be insufficient, particularly if those funds use multiple hedging instruments, unless certain exclusions for hedging transactions are permitted from the leverage calculations.</p> <p>Market Neutral strategies are another type of strategy cited by commenters that would be negatively impacted by the proposed total leverage limit, as well as the short selling limits.</p> <p>We were told that the proposed leverage restrictions would make it difficult to offer products that use global macro strategies, managed futures strategies and many risk parity and unconstrained bond strategies. It was further noted that Canadian retail investors already have far less access to these types of risk-managing products than investors in other countries due to the current derivatives restrictions in NI 81-102.</p> <p>We were also told that the proposed limit is too low and will restrict the ability of alternative funds to achieve their objectives through the use of derivatives and could have unintended consequences of alternative funds increasingly using long only strategies that are increasingly susceptible to market volatility.</p>	<p>We have, however, amended the leverage calculation to allow for the deduction of specified derivatives transactions that are for hedging purposes from the overall leverage limits which should provide greater flexibility. We have also included provisions in the Amendments to allow for some grandfathering of existing NRIFs.</p> <p>We are changing the leverage calculation methodology to allow for the deduction of hedging transactions from the gross notional exposure amount under section 2.9.1.</p> <p>Please see above regarding changes to the leverage calculation methodology. Please also see our earlier responses regarding our preferred approach for dealing with specific strategies like this as well as our earlier responses to comments regarding market neutral funds.</p> <p>Please see our responses above concerning changes to the leverage calculation methodology.</p> <p>We recognize that VaR is one of the methodologies permitted for measuring leverage risk employed under the UCITS framework. However, the leverage methodology under section 2.9.1 is not strictly intended as a measure of leverage risk – it is intended to</p>
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These commenters don't agree that using derivatives to gain exposure to assets increases the risk of a fund since they can have similar risk and return characteristics of the underlying asset and with proper risk controls in place, derivatives can provide certain benefits to the fund. These Commenters suggested that rather than imposing a single leverage limit, the CSA consider a broader approach and allow funds to disclose risk through value at risk (**VaR**), similar to the approach used in the European UCITS framework, as this would provide more flexibility. They agreed that there is value in disclosing notional exposure, and recommended that in addition to VaR, there be a requirement to disclose a fund's expected notional exposure, and that the fund be prohibited from exceeding those levels. This would provide a more complete picture of a fund's exposure and risk while allowing alternative funds greater flexibility to implement strategies.

Another commenter was not in favour of a one size fits all approach to measuring leverage and told us that the use of leverage does not imply higher risk than a fund that doesn't use leverage. This commenter added that the proposed leverage limits could be insufficient for certain strategies used by alternative funds. This commenter recommended a higher overall leverage limit in order to accommodate most alternative strategies, with a requirement that the maximum amount be disclosed in the Fund Facts.

Another commenter told us that NRIFs should not be subject to the same leverage limits as alternative funds as it would cause NRIF managers to cease to launch new offerings. In particular, the commenter believes NRIFs should not be subject to any kind of borrowing or leverage limit and that it should be left to market

be a uniform measure of economic exposure for the purposes of ensuring compliance with a prescribed regulatory limit. As such, we determined that it was more appropriate to employ a methodology that used clearly defined numbers, with less room for more subjective elements in order to facilitate comparability between funds and for measuring compliance with the regulatory limits. We also note that this approach is consistent with the more prescriptive approach taken to other investment restrictions under NI 81-102.

As noted above, we don't believe that a customized approach to calculating and measuring leverage is appropriate for introducing these concepts in the retail marketplace. We have however made amendments to the leverage calculation methodology which should allow for more flexibility, but we recognize that it will still not accommodate all alternative strategies.

We don't agree that NRIFs should necessarily be entitled to a higher leverage limit relative to alternative mutual funds and have not made this change. This view is part of the basis for the Interrelated Investment Restrictions. We further believe that the

<p>intermediaries to set those parameters. Alternatively, they recommend higher than what is currently proposed (e.g., 4x leverage, 150% borrowing and short selling), as well as permitting hedging or offsetting transactions to reduce this amount and allowing NRIFs to prescribe their own methodology for measuring exposure and requiring it be disclosed.</p>	<p>changes we have made to the leverage methodology will better accommodate more strategies in this space, which may address some of the concerns cited in this comment. We recognize that the Amendments will not accommodate all alternative strategies.</p>
<p><b>10. The method for calculating total leverage proposed under the Proposed 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 leverage 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 transaction that can reasonably be seen as reducing a fund’s net exposure to leverage?</b></p>	
<p style="text-align: center;"><u>Comments</u></p>	<p style="text-align: center;"><u>Response</u></p>
<p>Several commenters asked that we remove the proposed 3x limit on leverage and replace it with a requirement to disclose a fund’s expected maximum leverage as well as the methodology for measuring leverage to be used by the manager. These commenters noted that there are generally recognized methodologies for determining notional risk exposure under a derivatives transaction.</p> <p>Most commenters supported the idea that funds should be permitted to subtract or disregard from the total leverage calculation derivatives or other transactions (like short selling) used for hedging purposes, including: currency hedging, interest rate exposure and single name credit exposure. The intent would</p>	<p>Change not made. The Amendments contemplate an expansion of venues for alternative mutual funds to employ leverage (through cash borrowing and short-selling), and we feel it is a fair trade-off to subject this to an overall leverage limit as a means of limiting risk to the funds and that this approach is appropriate for retail-focused products.</p> <p>We note that these changes will have no impact on hedge funds or other mutual funds that are not reporting issuers and are sold only by way of prospectus exemptions, as these funds are not subject to NI 81-102.</p> <p>The leverage methodology has been amended to account for specified derivatives transactions that are for hedging purposes. Please see our earlier responses above on this point.</p>

be to allow for the subtraction of transactions that either reduce risk or that do not create additional leverage.

It was also recommended that we exclude from the calculation, any notional amount of short selling for hedging purposes and adjust the calculation to account for positions where the fund's immediate delivery obligation is tied to premiums paid rather than delivery of the entire notional amount. The view is that will exclude transactions that do not contribute to a fund's leverage and therefore alternative funds should not be discouraged from using them.

Some commenters suggested we consider increasing maximum leverage to more than 3x NAV. One of the commenters noted that there are funds currently in the market that have 4 times aggregate leverage without significantly increasing their long term volatility.

Another commenter also supported allowing funds to use "industry standard" calculation methods for the purposes of calculating an alternative fund's exposure to leverage as this will permit funds to apply the same methodology consistently for calculating gross exposure as well as their NAV.

This commenter also supported allowing funds to calculate their exposure net of any directly offsetting specified derivatives transactions that are the same type of instrument and have the same underlying reference asset, maturity and material terms, as these types of transactions are designed to reduce or eliminate a fund's economic exposure.

Please see our responses above concerning changes to the leverage methodology.

We have not made this change. Please see our response above concerning the changes we have made to the leverage calculation methodology.

We thank the commenter for the support and note that we have included wording in the CP to NI 81-102 to better clarify this.

As noted in our responses above, we have amended the leverage calculation methodology proposals to allow for some offsetting of hedging transactions.

<p>Other commenters agreed that funds should be permitted to net positions between derivatives instruments provided that the positions refer to the same underlying asset, even if the respective maturity date is different. These commenters also specifically supported the use of the “commitment method” for determining this, which is used in Europe.</p> <p>We were also told that allowing for offsetting/hedging transactions to be subtracted from the total leverage limit would give a more accurate picture of the fund’s actual market exposure or risk, which they do not believe is accurately reflected under a notional aggregate exposure calculation methodology.</p> <p>Others agreed that the leverage calculation should focus only on transactions that actually create leverage and disregard transactions that do not create additional leverage, similar to what is required for dealers under IROCC Rule 100.4.</p> <p>Some commenters noted that the proposed methodology creates an inconsistency between mutual funds and alternative funds, as mutual funds are essentially subject to no limit on the use of derivatives for hedging purposes, but alternatives would be restricted in the use of hedging under the proposed leverage limit and methodology. These commenters added that if the proposed methodology were applied to conventional mutual funds in the same manner it would effectively prohibit the use of hedging strategies by those funds as well.</p> <p>We were asked to provide clarification of the CSA’s expectations regarding “generally recognized standard for determining notional</p>	<p>Please see our responses above concerning changes to the leverage calculation for hedging transactions.</p> <p>Please see our responses above concerning changes to the leverage calculation for hedging transactions.</p> <p>Please see our responses above.</p> <p>Please see above. We believe the revisions to the methodology will address this concern.</p> <p>We have amended the CP language in NI 81-102 to offer more clarity on this point.</p>
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exposure” as described in proposed section 3.6.3 of the CP, including examples, in order to resolve any ambiguity in that wording.

Another commenter disagrees with a leverage calculation that uses gross notional amount in a manner that does not take netting or hedging into account. This commenter pointed towards both the SEC’s proposed rule 18f-4 and the UCITS rules in Europe, which both allow for some netting in their calculations, but suggests both approaches are unduly complex and overly restrictive. Instead, this commenter argues in favour of retaining a more principles-based approach that also allows funds to exclude from any leverage limits exposure from derivatives transactions used for hedging purposes.

Another commenter noted that the SEC is actively considering revisions to the proposed rule 18f-4 (which uses a similar methodology) in response to industry feedback. This commenter also expressed concern that if Canadian rules are too dissimilar to those in the US or Europe it may hamper access to derivatives by Canadian funds as non-Canadian counterparties may find it too inefficient to deal with Canadian funds, which will result in higher costs. This commenter also added that an aggregate notional amount calculation does not reflect the reality of a fund’s exposure as it doesn’t account for hedging transactions. They stated that what matters for the purposes of measuring this exposure is a fund’s actual mark-to-market net exposure as that reflects the actual amount at risk to the fund and that any concerns about the risk of loss of capital can be mitigated by ensuring the aggregate net exposure of derivatives positions does not exceed 100% of NAV. This commenter suggests that if the counterparty exposure restrictions in subsection 2.7(4) of NI 81-102 were revised in this manner, an overall leverage limit will be unnecessary.

Please see our responses above concerning changes to the leverage calculation methodology.

Please see our responses above concerning changes to the leverage methodology. While we look to other jurisdictions to help inform our rule-making, we try to craft our rules in a way that recognizes that our market is different.

This commenter further added that the current definition of “hedging” in NI 81-102 is difficult to administer under the approach to derivatives taken by many Canadian mutual funds because certain hedges such as interest rate hedges are not simply correlation hedges and would therefore be offside clause (ii) of that definition. They suggest that clauses (i) and (iii) of the definition would be sufficient for these purposes and would allow for more easily drafting exclusionary language for use in a leverage limit calculation.

Several commenters thought the current definition of “hedging” in NI81-102 is sufficient for describing actives that offset exposure to leverage.

Another commenter recommended specific modifications to the derivatives aspect of the leverage calculation to ensure sufficient flexibility for alternative strategies while imposing reasonable limits on leverage, including the following:

- Exclude derivatives transactions for hedging purposes entirely, which is consistent with the approach used for mutual funds under NI 81-102.
- Focus the calculation only on transactions that actually create an obligation.
- Consider the nature of the underlying assets.
- Allow funds to enter into an offsetting transaction to reduce their exposure rather than being forced to close out positions.

The commenters note that if the CSA is not receptive to these options, then it should consider increasing the leverage limit instead.

We did not consider any changes to the definition of “hedging” as it would have an impact that is beyond the scope of the Project.

We thank the commenters for the support.

Please see our responses above regarding changes to the leverage calculation methodology.

<p>Another commenter expressed concern that the look through requirements in the leverage calculation could be operationally difficult to manage from a compliance standpoint and may drive managers to only invest in affiliated underlying funds.</p>	<p>The purpose of the look through provisions is to ensure that funds cannot indirectly circumvent the restrictions through fund of fund investing. We expect managers to take the appropriate steps to ensure that they have the necessary access to these measures from any underlying funds they invest in to properly manage this.</p>
<p><b>11. We note that the proposed leverage calculation method has its limits and its applicability through different types 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 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.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>Several commenters told us that multiple measures of leverage should be permitted in order to address the variability of different strategies, and that clear disclosure of those measures will also be required.</p> <p>Several other commenters specifically supported utilizing the VaR model used for UCITS in Europe and it believes this takes a more holistic approach to risk assessment.</p> <p>Some commenters thought that the “sum of notionals” approach may not be an appropriate measure of risk and could be misleading. They do not believe that a single methodology exists that accurately explains leverage in all cases and suggests therefore that any single prescriptive approach will unfairly penalize some strategies over others. While they support limits on borrowing and short selling, they do not support creation of a</p>	<p>Change not made. We are of the view that having multiple measures in this manner would be confusing for investors and would hamper comparability across funds.</p> <p>Change not made. Please see our responses above regarding our views on using VaR as the leverage calculation methodology for alternative mutual funds under NI 81-102.</p> <p>We believe the adjustments we've made to the leverage calculation methodology will address some of these concerns. Please see our responses above on that point. Please also see our responses above outlining the reasons we are not using VaR as the leverage calculation methodology under the Amendments.</p>

<p>single limit for leverage, as the risks represented by derivatives are distinct enough to require a different approach. These commenters also support the use of the VaR framework which is used in Europe.</p> <p>They also suggest requiring funds to provide, in addition to their disclosure of their notional exposure, a practical example of how each derivative instrument in the portfolio is being handled. They believe this will force managers to invest in more sophisticated risk control procedures and compliance oversight.</p> <p>Another commenter is generally supportive of the proposed notional exposure methodology for cash borrowing. For derivatives, they suggest that mark-to-market exposure be the measure, rather than aggregate notional as it better reflects the market reality of most derivatives transactions.</p> <p>One commenter also noted that the gross notional exposure measure of leverage is not used in Europe and cited a recent hedge fund survey by the Financial Conduct Authority in the United Kingdom that states that gross leverage measures do not accurately represent an amount of money/value at risk. This commenter added that in certain scenarios a hard wired leverage limit can increase a fund's distress by forcing it to sell or unwind positions at inopportune times and can therefore impact a manager's ability to manage risk in those situations.</p> <p>Another commenter expressed that they were generally satisfied</p>	<p>We encourage funds to improve their prospectus disclosure as they deem to be appropriate within the framework of the various Form requirements.</p> <p>Please see our responses above concerning the changes made to these provisions.</p> <p>Please see our responses above concerning why we chose this leverage calculation methodology in favour of others like VaR. Please also note that we have amended the methodology to allow for the deduction of specified derivatives transactions that are for hedging purposes. The Amendments also provide for funds that exceed the limit to take commercially reasonable steps to get under the limit, which we believe helps to mitigate the risk of a forced sale in distressed markets.</p> <p>We thank the commenter for their support.</p>
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with use of notional amount for calculation of leverage.	
<p><b>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.</b></p>	
<u><b>Comments</b></u>	<u><b>Response</b></u>
<p>One commenter is concerned that narrowing investment restrictions for NRIFs will result in far less innovative offerings, given their higher cost and narrower distribution channels.</p> <p>Another commenter agreed, adding that cash borrowing in particular should not be too restricted, as there is little to no counterparty risk. This commenter added access to cash is important for less liquid NRIFs and that prudential standards imposed on Canadian banks/trust companies may make them slow to respond at times and limit the availability of borrowing. This could impact the ability of the smaller NRIFs to obtain financing on favourable terms or at all. This commenter expressed that there is no overarching benefit to restricting access to cash borrowing for NRIFs.</p> <p>A different commenter doesn't believe there should be any restriction on short selling for NRIFs. This commenter noted that short selling restrictions in the Proposed Amendments appear to have an implicit bias towards the use of derivatives.</p>	<p>We believe the proposed investment restrictions are reasonable for retail-focused products and will accommodate a variety of strategies while maintaining limits or controls on those strategies that we believe are appropriate for retail-focused products.</p> <p>NRIFs and alternative mutual funds will be permitted to borrow cash up to 50% of NAV and as noted above, we have expanded the range of permitted lenders from what was initially proposed. We believe this will provide sufficient access to cash borrowing for NRIFs.</p> <p>We believe the short selling provisions allow for more flexibility in the use of this strategy than is currently permitted for mutual funds and commodity pools under NI 81-102, while keeping appropriate controls in place for this strategy in the retail space. The restrictions proposed for NRIFs are the same as those proposed for alternative mutual funds.</p>

<p>We were also told that the particular investment restrictions for NRIFs were negotiated amongst the various intermediaries and do not appear to have created any issues that would have necessitated these changes. These commenters believe disclosure is sufficient and the prescribed investment restrictions are unnecessary.</p>	<p>We do not agree that relying solely on intermediaries and disclosure is sufficient for regulating NRIFs, which are sold to the same investors as mutual funds subject to a more robust regulatory framework. One of the goals of the Modernization Project was to integrate NRIFs into the NI 81-102 regulatory framework, and establishing appropriate investment restrictions for NRIFs is a key part of that goal. We do not believe the restrictions set out in the Amendments will unduly hamper the investment strategies available to NRIFs. Nonetheless, the Amendments provide for some grandfathering of existing NRIFs that may be impacted by the changes.</p>
<p><b>13. Are there any changes to the form requirement for Fund Facts, in addition to or instead of those proposed under the Proposed 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 the 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.</b></p>	
<p style="text-align: center;"><u><b>Comments</b></u></p>	<p style="text-align: center;"><u><b>Response</b></u></p>
<p>Regarding the proposed text box disclosure, we were told by a number of commenters that it may be difficult to include all of the proposed information. Instead it was suggested that disclosure pertaining to the features and strategies of the alternative fund be provided under the applicable headings that already speak to those matters. These commenters added that the proposed text box disclosure is unnecessary and may require further explanations which may be at odds with the goal of the fund facts. They suggested instead the inclusion of a simple statement that a fund is an alternative fund and that it has the ability to invest in assets or use strategies not permitted by other mutual funds, and encourages investors to read the prospectus.</p>	<p>We believe this disclosure is necessary so that investors understand that they are considering investing in a product that is unlike other types of mutual funds, and that has access to strategies that are not otherwise available in the retail mutual fund space. As such, it is important that the nature of these funds be clearly distinguished from other, more conventional mutual funds. We also do not agree that the current Funds Facts/ETF Facts format will be unable to accommodate this additional disclosure. We further note that the prospectus requirements in the Amendments are consistent with the recent regulatory changes for other mutual funds to have the Funds Facts or ETF Facts be the only disclosure document delivered to investors at the time the investment decision is being made.</p>

A number of commenters also expressed concerns with the proposed “warning language”. They believe the statements about the potential for losing money are overly dire and not entirely accurate in light of modern day alternative funds relative to mutual funds.

These commenters are felt it was unfair to mandate this warning language for alternative funds when no similar warning is needed for NRIFs, as it implies that alternative funds are inherently riskier.

There was also concern expressed with the proposals that would require comparative disclosure between alternative funds and other mutual funds as it could be misleading to investors.

One of those commenters noted for example that for ETF Facts there is only a requirement to disclose unique trading and pricing characteristics of ETFs but no requirement for comparative language with other mutual funds.

We think it prudent to advise investors that certain of the strategies that can be employed by an alternative mutual fund (and that distinguish these funds from other types of mutual funds) are different from those permitted for conventional mutual funds and that they can have a different risk of loss. As noted above, this is particularly the case as these funds will have access to strategies that have not been previously available in the retail mutual fund space.

The requirement to prepare a Funds Facts/ETF Facts currently only applies to mutual funds, which will include alternative mutual funds. Extending this requirement to NRIFs is beyond the scope of this Project.

We do not agree that requiring this comparative language will be misleading to investors.

The unique disclosure requirements for ETF Facts are based on the fact that they are listed products and therefore have a different distribution and trading model than mutual funds that are not listed. This is what primarily distinguishes ETFs from mutual funds that are not listed. They are subject to substantially the same investment restrictions and therefore similar comparative language about investment strategies is unnecessary. The specific disclosure requirements applicable to alternative mutual funds, which are distinguishable from other mutual funds by virtue of the strategies they are permitted to employ or assets they can invest in, are consistent with this approach.

We also note that alternative mutual funds that are listed for trading will be required to use the ETF facts and the same

<p>This commenter also felt that disclosure requiring an alternative fund to state that it is an alternative fund is not consistent with the CSA’s expressed intent not to mandate naming or labelling conventions for alternative funds.</p> <p>Another commenter urged the CSA to be consistent in disclosure rules and abandon comparisons between conventional mutual funds and alternative funds in relevant disclosure documents and instead ensure the disclosure focuses on features that are unique to alternative funds.</p> <p>This commenter added, however, that given the additional complexity and risk that alternative strategies and leverage introduce they were not sure that a Fund Facts is appropriate for the level of disclosure needed to properly explain this to investors.</p> <p>One commenter suggested requiring a textbox permitting a brief description of an alternative fund’s expected leverage or types of derivatives to be permitted, if the VaR methodology adopted.</p> <p>One commenter believes that while disclosure is necessary it is not</p>	<p>disclosure requirements for alternative mutual funds included in the Fund Facts will apply to the ETF Facts as well.</p> <p>We disagree. Alternative mutual fund will be a defined term under securities legislation, so it is appropriate to require funds to identify themselves as such. We do not agree that this can be equated to a naming convention. We further note that a similar identification requirement already exists for funds that prepare a long form prospectus under Form 41-101F2, which is currently the only prospectus form that is used by more than one type of investment fund (e.g. NRIFs, commodity pools and ETFs).</p> <p>Alternative mutual funds are defined by how they can invest in asset classes and use strategies that are not available to other types of mutual funds. The disclosure requirements are therefore consistent with how these funds are defined.</p> <p>The Fund Facts/ETF Facts is now the only disclosure document provided to mutual fund investors at or near the point of sale so it is, in our view, an appropriate document for this type of disclosure. We note that commodity pool ETFs, which can use some of the strategies that will be permitted for alternative mutual funds, currently use the ETF Facts as their primary disclosure document.</p> <p>As noted above, VaR will not be the leverage methodology used under the Amendments.</p> <p>The concern is noted. The existing disclosure requirements for</p>
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sufficient on its own to provide investor protection. This commenter added that any summary document should focus extra attention on risk disclosure, redemption constraints and taxation more so than current fund facts for mutual funds.

Another commenter expressed concerns with the statement in the Notice about the CSA's goal of harmonizing the disclosure regime for mutual funds and suggested that this is an ominous statement for the future of the exempt market in Canada. This commenter believes that the Proposed Amendments will increase the risk and reduce the returns of hedge funds. This commenter added that the disclosure proposals for alternative funds appears oblivious to the dangers of disclosing short positions as it could result in a "short squeeze" against the fund and suggests this is a key reason why liquid alternative funds have failed to replicate the success of their hedge fund counterparts in Europe and the US.

Some commenters recommended to us that we consult specifically on the content of any proposed alternative fund point of sale disclosure, and as part of this consultation it was suggested we provide for comment, a sample Fund Facts for alternative funds, with the proposed new disclosure.

Fund Facts and ETF Facts require this type of disclosure, which must be tailored to the specifics of the particular fund. This will also apply to alternative mutual funds. As noted above, there is also specific additional disclosure for alternative mutual funds that focuses on the different strategies permitted by these products and the impact of those strategies on the potential risk of loss.

The Amendments will only apply to funds that are reporting issuers subject to NI 81-102. Hedge funds that are sold in the exempt market will not be subject to these requirements and the statement referenced in the comment about harmonizing the disclosure regime for mutual funds does not refer to or include hedge funds.

We further note that the portfolio disclosure requirements for Fund Facts and ETF Facts do not require real time disclosure of portfolio holdings, nor does it require disclosure of a fund's full portfolio, so we do not agree that it exacerbates the risk of a short squeeze. We note that conventional mutual funds, which already have the ability to short sell, are currently required to provide this disclosure in the same manner as is proposed for alternative mutual funds.

We do not agree that the additional disclosure requirements for alternative mutual funds set out in the Amendments warrant specific consultation as they can be addressed in the course of the prospectus review process as the other disclosure requirements were. We do not expect this additional disclosure to materially alter the format of the Fund Facts or ETF Facts.

<p>One commenter generally agrees with the proposals but believes they will need periodic review.</p> <p>Other commenters made note of the proposal to introduce fund facts for unlisted alternatives, and the impending requirement for an ETF Facts, to highlight that NRIFs will be one of the few investment products that cannot transact based on a summary disclosure document, and that the policy reasons for this exclusion are unclear.</p> <p>We were told that modifications to the mandatory risk disclosure will be needed for alternative funds that will adequately highlight the risks of alternative funds in light of liquidity constraints, leverage, derivatives and otherwise. This commenter added that any prescribed text box should use terms the average retail investor will understand.</p>	<p>We agree and note that we do periodically review the investment restrictions in NI 81-102 to determine if they need updating. The current Modernization Project is the result of such an exercise.</p> <p>This concern is noted. The decision of whether to introduce a similar summary disclosure document for NRIFs is beyond the scope of this Project.</p> <p>We note that alternative mutual funds will have the same liquidity requirements as more conventional mutual funds and note that the additional disclosure requirements for alternative mutual funds include discussion of the impact of the strategies it uses. Fund Facts and ETF Facts are already required to use plain language wording to facilitate investor understanding and this expectation is not changing under the Amendments.</p>
<p><b>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 Proposed 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?</b></p>	
<p style="text-align: center;"><u>Comments</u></p>	<p style="text-align: center;"><u>Response</u></p>

<p>Several commenters told us they agree that the same general risk classification methodology should be used for conventional and alternative funds but that the methodology should be altered to allow managers to use other risk measures besides standard deviation.</p> <p>These commenters also anticipate some challenges for alternative fund managers and recommends revisiting/consulting on the methodology before going final on the Proposed Amendments.</p> <p>Other commenters agreed that more work may need to be done on the Methodology for alternative funds, but appreciated that there will not be a presumption that alternative funds are necessarily always riskier than more conventional mutual funds.</p> <p>Another commenter also agreed with using a single standard but cautions that the CSA not impose a higher risk rating on alternative funds solely as a result of their strategies. This commenter also seeks guidance with respect to Risk Classification Methodology in light of alternative strategies that may not have a comparable permitted index for the purposes of the Methodology.</p> <p>Another commenter also wants the CSA to ensure there are clear rules about how the risk classification methodology is to be used for alternative funds before Proposed Amendments go final.</p> <p>Another commenter agreed that a single measure of risk across all retail mutual funds fosters helpful benchmarking and comparisons and believes that any shortcomings in using standard deviation as</p>	<p>We have decided not to change the Methodology for alternative mutual funds, as we believe using the same methodology across all mutual funds will foster greater comparability of risk ratings for those funds. We have however, included additional commentary for the Methodology to provide further guidance on additional factors to consider for funds that use strategies that may produce atypical performance distribution under the standard deviation calculation used for the Methodology, including the use of “upside discretion” for risk ratings permitted under the Methodology.</p> <p>Please see our response above.</p> <p>Please see our response above.</p> <p>Please see our response above.</p> <p>We thank the commenter for the support.</p>
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a risk measure for alternative funds are not significant and are outweighed by the benefits of a single standard.

Another commenter was pleased that standardized methodology for risk was adopted but disappointed that the proposed numerical scale was not accompanied by a narrative description of its limitations and an explanation of risks not covered in the scale, as is mandated in Europe and cited by IOSCO in its point of sale disclosure report.

Other commenters also supported the use of standard deviation as the risk measure for alternative funds. However, they do not believe that alternative funds with less than 10 years history should be required to use the reference index performance as contemplated in the Methodology. The concern is that without additional flexibility, appropriate reference indexes may not be identifiable. These commenters recommended that the reference index requirement within the Methodology be amended to afford greater flexibility to alternative fund managers so that managers have some discretion to adjust the risk rating where the most appropriate reference index does not, in the manager's opinion, accurately reflect returns. The manager would also be required to explain the use of any such discretion in the fund facts.

One of those commenters also suggests that in addition to allowing discretion to use qualitative factors, fund managers should also be allowed to use such other risk methodologies as they may deem to be more appropriate, provided that an explanation of methodology is provided in the fund's disclosure documents, including any material differences with the Methodology.

We thank the commenter for the support. The Methodology was enacted as part of a different CSA initiative and therefore changes of this kind are beyond the scope of this Project. We note however, that the prospectus disclosure requirements associated with the Methodology include a statement that the Methodology only measures volatility.

Change not made. Please see our response above concerning the decision to use the Methodology for alternative mutual funds, including the additional guidance included as part of the Amendments. We note that the Methodology already affords managers some discretion in applying the appropriate risk rating to their fund, to better reflect its expected risk profile.

Please see our response above.

<p>One commenter advocated for the adoption of VaR as a risk measure, similar to what is used in Europe for UCITS, conditional on certain additional controls like back testing. This commenter does not believe that the introduction of VaR will be a significant challenge for larger asset managers operating in Canada.</p> <p>Other commenters agreed that standard deviation alone may not be sufficient in light of the various strategies that can be employed by alternative funds and that additional metrics such as VaR should also be considered.</p> <p>Another commenter does not agree with volatility as a useful measure of risk and would object to anything similar for alternative funds.</p>	<p>Change note made. However, we note that the additional commentary for the Methodology provided does contemplate managers considering the use of additional methodologies or factors to help arrive at an appropriate risk rating if they feel it is necessary to better reflect the fund’s risk profile.</p> <p>Please see our response above.</p> <p>Change not made. The risk measure used for the Methodology was developed under a different CSA initiative and as noted above was intended to apply to all mutual funds subject to NI 81-102. Changing the metric as the commenter suggests is beyond the scope of this Project.</p>
<p><b>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 regime.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>Most of the respondents who commented on this question did not foresee significant unique challenges for alternative funds implementing point of sale.</p> <p>It was suggested the biggest challenge would be in educating those dealers required to deliver the documents and that the training to transition to this new regime could result in some transition costs for distributors.</p>	<p>We thank the commenters for their support</p> <p>We agree and thank the commenters for the feedback.</p>

<p>One commenter urged the CSA to specifically permit managers to consolidate both alternative funds and conventional mutual funds into the same prospectus given that the disclosure requirements will be substantially similar under the Proposed Amendments.</p>	<p>Change not made. This requirement is consistent with current disclosure requirements that prohibit combining commodity pools with other types of mutual funds in the same prospectus document.</p>
<p><b>16. We are seeking feedback on the proposed transition periods under the Proposed Amendments and whether they are sufficient to allow existing funds to transition to the updated regulatory regime? Please be specific.</b></p>	
<p style="text-align: center;"><b><u>Comments</u></b></p>	<p style="text-align: center;"><b><u>Response</u></b></p>
<p>Some commenters told us the proposed transition period should be adequate.</p> <p>We were warned however, that some existing funds that may be adversely impacted, or may struggle to adapt to the changes, may need more time to adjust their portfolios to the new restrictions.</p> <p>It was also noted that there could be additional costs in forcing existing funds to change strategies, such as unitholder approvals and other operational costs, as well as possible tax implications.</p> <p>One commenter suggested that we grandfather existing funds or exempt them having to transition to the new regime to recognize the commercial bargain between investors and the funds at the time of their creation or purchase. This commenter also made specific recommendations regarding transition:</p>	<p>We thank the commenters for their views. We have made some changes to the transition provisions to afford existing funds additional time to adapt to the changes.</p> <p>For NRIFs, the transition provisions allow for grandfathering of existing funds that may be unduly impacted by the changes, subject to certain conditions. For commodity pools, we have adjusted to transition provisions to allow for more time to make any necessary adjustments to accommodate the Amendments. We note that if specific issues arise that are accounted for in the transition periods, there may be other avenues for managers to address these concerns, such as applying for exemptive relief.</p> <p>Please see our response above.</p> <p>Please see our responses above regarding grandfathering of existing NRIFs.</p>

<ul style="list-style-type: none"> <li>• Allow existing commodity pools to make any necessary changes by the time of their next renewal prospectus as long as it is more than 3 months after rules come into force.</li> <li>• Commodity pools that do not wish to comply with the new rules be allowed to continue operations “as is” provided they close their funds to new purchases no more than 1 year after the rules come into force.</li> <li>• After the rules come into force, any Private/hedge fund that wishes to become an alternative fund must become compliant as of the time of filing its preliminary prospectus.</li> <li>• Any public mutual fund that wants to convert to an alternative fund after the rules come into force be required to make the necessary changes to objectives/strategies and file an amended and restated prospectus if changes come into force before the next prospectus renewal.</li> </ul> <p>Other commenters recognized that the period required to adjust to the new regime will be determined by the final implemented changes and encourages CSA to allow enough time for funds to adapt. These commenters suggested at least a year following publication of the final rules which would allow for proper revisions of disclosure documents, to apply for exemptive relief if necessary, or for any other necessary operational changes.</p> <p>It was also suggested that we consider different timelines for</p>	<p>The transition provisions are consistent with this suggestion.</p> <p>Change not made. We have decided that from a regulatory compliance standpoint it is more appropriate to have the same transition provisions apply to existing commodity pools.</p> <p>The transition provisions are consistent with this suggestion.</p> <p>The transition provisions are consistent with this suggestion. We note that since the definition of alternative mutual fund includes a requirement that its fundamental investment objectives state that it uses strategies not otherwise permitted by mutual funds, we would expect that any conventional mutual fund that would seek to convert to an alternative mutual fund would necessarily have to amend its investment objectives (and take any necessary regulatory steps in connection with such a fundamental change) in order to give effect to such a conversion.</p> <p>Please see our responses above regarding changes to the transition provisions.</p> <p>The transition provisions accommodate this. In particular, we</p>
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<p>implementing different aspects of proposals. This commenter noted for example that concentration or illiquid asset restrictions should be implemented in such a way as to not to cause a forced sale of assets by existing funds.</p> <p>We were also encouraged to inform the market as soon as possible if grandfathering will be permitted and to what extent.</p> <p>Some commenters told us that an alternative fund should have the flexibility to be either a mutual fund or an NRIF. If it's listed it should be required to have an annual redemption at NAV and if it's not listed, be able to adopt a redemption frequency of its choosing.</p>	<p>have allowed more time for funds to adjust to the investment restrictions and certain of the prospectus requirements relative to the other changes contemplated under the Amendments.</p> <p>We have announced these provisions in connection with the publication of the Amendments, and note that there will be a 90 day period between publication and coming into force of the Amendments, which should provide adequate notice of the applicability of the transition provisions.</p> <p>The term “alternative mutual fund” only applies to mutual funds, but the investment restrictions applicable to alternative mutual funds and NRIFs are substantially similar, so a fund could opt to launch as a NRIF or an alternative mutual fund without any significant impact on the strategies it can use. We note that our rules do not mandate any particular redemption frequency for mutual funds.</p>
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**Part IV – LIST OF COMMENTERS**

**Commenters**

- **AGF Investments Inc.**

- **Alternative Investment Management Association (AIMA)**
- **Arrow Capital Management Inc.**
- **AUM Law Professional Corporation**
- **Aviva Investors Canada Inc.**
- **BlackRock Asset Management Canada Limited**
- **BMO Capital Markets and BMO Global Asset Management**
- **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 Imperial Bank of Commerce**
- **Canadian Securities Institute, The (CSI)**
- **East Coast Fund Management Inc.**
- **First Asset Investment Management Inc.**
- **Jeffrey L. Glass and Darrin R. Renton**
- **Invesco Canada Ltd.**
- **Investment Funds Institute of Canada, The (IFIC)**
- **Investors Group Inc.**
- **Irwin, White & Jennings (on behalf of Growthworks Capital Ltd.)**
- **Kenmar Associates**
- **Lawrence Park Asset Management Ltd.**
- **Lightwater Partners Ltd.**
- **Lysander Funds Limited**
- **Mackenzie Financial Corporations**
- **Manulife Asset Management Limited**
- **McCarthy Tétrault LLP**
- **McMillan LLP**
- **Morgan Meighen & Associates Limited**
- **Picton Mahoney Asset Managements**
- **Portfolio Management Association of Canada**
- **Hedge Fund Standards Board**

- **RBC Capital Markets**
- **RBC Global Asset Management Inc.**
- **RP Investment Advisors**
- **Stikeman Elliott LLP (Financial Products and Services Group)**
- **Sun Life Global Investments (Canada) Inc.**
- **TD Securities Inc.**
- **Tim McElvaine**
- **Vision Capital Corporation**
- **Wildeboer Dellece LLP**

## ANNEX C-1

FINANCIAL AND  
CONSUMER SERVICES  
COMMISSION

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COMMISSION DES SERVICES  
FINANCIERS ET DES SERVICES  
AUX CONSOMMATEURS

réglementation • éducation • protection

### AMENDMENTS TO NATIONAL INSTRUMENT 81-102 INVESTMENT FUNDS

1. *National Instrument 81-102 Investment Funds is amended by this Instrument.*
2. *Section 1.1 is amended*
  - (a) *by repealing the definition of “acceptable clearing corporation”,*
  - (b) *in the definition of “cash cover” by replacing “a mutual fund” with “an investment fund”, and by replacing “the mutual fund” with “the investment fund” wherever it occurs,*
  - (c) *in the definition of “clearing corporation” by replacing “options or standardized futures” with “specified derivatives”,*
  - (d) *by repealing the definition of “fixed portfolio ETF”,*
  - (e) *in the definition of “illiquid asset” by replacing “mutual fund” with “investment fund” in paragraph (a) and by replacing “a mutual fund, the resale of which is prohibited by a representation, undertaking or agreement by the mutual fund or by the predecessor in title of the mutual fund” with “an investment fund” in paragraph (b),*
  - (f) *by repealing the definition of “Joint Regulatory Financial Questionnaire and Report”,*
  - (g) *by repealing the definition of “permitted gold certificate”,*
  - (h) *in the definition of “physical commodity” by adding “electricity, water, or,” before “in an original or processed state”,*
  - (i) *by replacing the definition of “public quotation” with the following:*

“public quotation” includes, for the purposes of calculating the amount of illiquid assets held by an investment fund, any quotation of a price for any of the following:

- (a) a fixed income security made through the inter-dealer bond market,
  - (b) a foreign currency forward or foreign currency option in the interbank market;,
- (j) **in the definition of “restricted security” by replacing “mutual fund or by the mutual fund’s predecessor” with “investment fund or by the investment fund’s predecessor”, and**
- (k) **by adding the following definitions:**

“alternative mutual fund” means a mutual fund, other than a precious metals fund, that has adopted fundamental investment objectives that permit it to invest in physical commodities or specified derivatives, to borrow cash or engage in short selling in a manner not permitted for other mutual funds under this Instrument;,

“cleared specified derivative” means a bilateral specified derivative that is accepted for clearing by a regulated clearing agency;,

“fixed portfolio investment fund” means an exchange traded mutual fund not in continuous distribution or a non-redeemable investment fund that

- (a) has fundamental investment objectives that include holding and maintaining a fixed portfolio of publicly traded equity securities of one or more issuers the names of which are disclosed in its prospectus, and
- (b) trades the securities referred to in paragraph (a) only in the circumstances disclosed in its prospectus;,

“non-redeemable investment fund” has the meaning ascribed to that term in National Instrument 81-106 *Investment Fund Continuous Disclosure*;

“permitted precious metal” means gold, silver, platinum or palladium;,

“permitted precious metal certificate” means a certificate representing a permitted precious metal if the permitted precious metal is held in Canada in the form of bars or wafers and is

- (a) available for delivery in Canada, free of charge, to or to the order of the holder of the certificate,
- (b) in the case of a certificate representing gold, of a minimum fineness of 995 parts per 1000,

- (c) in the case of a certificate representing silver, platinum or palladium, of a minimum fineness of 999 parts per 1000, and
- (d) if not purchased from a bank listed in Schedule, I, II or III of the *Bank Act* (Canada), fully insured against loss and bankruptcy by an insurance company licensed under the laws of Canada or a jurisdiction;

“precious metals fund” means a mutual fund that has adopted a fundamental investment objective to invest primarily in one or more permitted precious metals; **and**

“regulated clearing agency” has the meaning ascribed to that term in National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*;

**3. Section 1.2 is amended**

(a) **in paragraph 1.2(3)(a) by replacing** “sections 2.12 to 2.17;” **with** “section 2.6.1 and sections 2.7 to 2.17;”, **and**

(b) **by adding the following subsection:**

(5) Despite paragraph (1)(a.1), the following provisions do not apply to a non-redeemable investment fund that was established before October 4, 2018, unless the fund has filed a prospectus for which a receipt was issued after that date:

- (a) sections 2.1 and 2.4,
- (b) paragraphs 2.6(1)(a), (b) and (c), and subsection 2.6(2), and
- (c) sections 2.6.1, 2.6.2 and 2.9.1..

**4. Section 2.1 is amended**

(a) **in subsection (1) by replacing** “A mutual fund” **with** “A mutual fund, other than an alternative mutual fund,”, **by replacing** “index participation units” **with** “an index participation unit”, **by replacing** “10 percent” **with** “10%” **and by adding** “one” **after** “any”,

(b) **by adding the following subsection:**

(1.1)1. An alternative mutual fund or a non-redeemable investment fund must not purchase a security of an issuer, enter into a specified derivatives transaction or purchase an index participation unit if, immediately after the transaction, more than 20% of its net asset value would be invested in securities of any one issuer.,

(c) **in subsection (2) by replacing "Subsection (1) does" with "Subsections (1) and (1.1) do", by replacing "a mutual fund" with "an investment fund" wherever it occurs, and in paragraph (e) by replacing "fixed portfolio ETF" with "fixed portfolio investment fund",**

(d) **by replacing subsection (3) with the following:**

(3) For the purposes of this section, for each long position in a specified derivative that is held by an investment fund for a purpose other than hedging and for each index participation unit held by the investment fund, the investment fund is considered to hold directly the underlying interest of that specified derivative or its proportionate share of the securities held by the issuer of the index participation unit., **and**

(e) **by replacing subsection (4) with the following:**

(4) Despite subsection (3), for the purposes of this section, an investment fund is considered to not hold a security or instrument if that security or instrument is a component of, but represents less than 10% of,

(a) a stock or bond index that is the underlying interest of a specified derivative, or

(b) the securities held by the issuer of an index participation unit..

5. **Section 2.3 is amended**

(a) **in subsection (1) by adding "do any of the following:" after "must not",**

(b) **in paragraph (1)(c) by replacing "10 percent" with "10%",**

(c) **by replacing paragraph (1)(d) with the following:**

(d) purchase a precious metal certificate, other than a permitted precious metal certificate;,,

(d) **by replacing paragraph (1)(e) with the following:**

- (e) purchase a permitted precious metal, a permitted precious metal certificate, or a specified derivative of which the underlying interest is a physical commodity if, immediately after the purchase, more than 10% of the mutual fund's net asset value would be made up of permitted precious metals, permitted precious metal certificates, or specified derivatives of which the underlying interests are physical commodities;

**(e) by replacing paragraph (1)(f) with the following:**

- (f) purchase a physical commodity, except to the extent permitted by paragraph (d) or (e);

**(f) by adding "or" to the end of paragraph (1)(g),**

**(g) by repealing paragraph (1)(h),**

**(h) by adding the following subsections:**

- (1.1) Paragraphs (1)(d), (e) and (f) do not apply to an alternative mutual fund.
- (1.2) Paragraph (1)(e) does not apply to a precious metals fund with respect to purchasing a permitted precious metal, a permitted precious metal certificate or a specified derivative of which the underlying interest is one or more permitted precious metals., **and**

**(i) by adding the following subsections:**

- (3) For the purposes of this section, for each long position in a specified derivative that is held by an investment fund for a purpose other than hedging and for each index participation unit or underlying investment fund held by the investment fund, the investment fund is considered to hold directly the underlying interest of that specified derivative or its proportionate share of the assets held by the issuer of the index participation unit or underlying investment fund.
- (4) Despite subsection (3), for the purposes of this section, an investment fund is considered to not hold a security or instrument if that security or instrument is a component of, but represents less than 10% of,
  - (a) a stock or bond index that is the underlying interest of a specified derivative, or
  - (b) the securities held by the issuer of an index participation unit or underlying investment fund..

6. **Section 2.4 is amended**

- (a) **by replacing “percent” with “%” wherever it occurs,**
- (b) **in subsection (2) by replacing “must not have invested,” with “must not hold,”, and**
- (c) **by adding the following subsections:**
  - (4) A non-redeemable investment fund must not purchase an illiquid asset if, immediately after the purchase, more than 20% of its net asset value would be made up of illiquid assets.
  - (5) A non-redeemable investment fund must not hold, for a period of 90 days or more, more than 25% of its net asset value in illiquid assets.
  - (6) If more than 25% of the net asset value of a non-redeemable investment fund is made up of illiquid assets, the non-redeemable investment fund must, as quickly as commercially reasonable, take all necessary steps to reduce the percentage of its net asset value made up of illiquid assets to 25% or less..

7. **Subsection 2.5(2) is amended**

- (a) **by replacing paragraph (a) with the following:**
  - (a) if the investment fund is a mutual fund, other than an alternative mutual fund, either of the following applies:
    - (i) the other investment fund is a mutual fund, other than an alternative mutual fund, that is subject to this Instrument;
    - (ii) the other investment fund is an alternative mutual fund or a non-redeemable investment fund that is subject to this Instrument and, at the time of the purchase of that security, the investment fund holds no more than 10% of its net asset value in securities of alternative mutual funds and non-redeemable investment funds,,
- (b) **in paragraph (a.1) by adding “an alternative mutual fund or” before “a non-redeemable investment fund” wherever it occurs,**
- (c) **by replacing paragraph (c) with the following:**
  - (c) the other investment fund is a reporting issuer in a jurisdiction,, **and**

- (d) **by repealing paragraph (c.1).**
  
- 8. **Subsection 2.5(3) is amended by replacing “(a.1), (c) and (c.1)” with “(a.1) and (c)”.**
  
- 9. **Subsection 2.5(5) is replaced with the following:**
  - (5) Paragraphs (2)(e) and (f) do not apply to brokerage fees incurred for the purchase or sale of securities issued by an investment fund that are listed for trading on a stock exchange..
  
- 10. **Section 2.6 is amended**
  - (a) **by adding “Borrowing and Other” before “Investment Practices” in the heading,**
  - (b) **by renumbering it as subsection 2.6(1),**
  - (c) **in subsection (1) by replacing “not,” with “not”,**
  - (d) **in paragraph (1)(a) by deleting “in the case of a mutual fund”,**
  - (e) **in subparagraph (1)(a)(i) replacing “mutual fund” with “investment fund” wherever it occurs, and by replacing “five percent” with “5%”,**
  - (f) **in subparagraph (1)(a)(ii) and (iii) by replacing “mutual fund” with “investment fund”,**
  - (g) **in subparagraph (1)(a)(iv) by adding “or a non-redeemable investment fund” after “continuous distribution”,**
  - (h) **in paragraphs (1)(b) and (c) by deleting “in the case of a mutual fund”, and**
  - (h) **by adding the following subsection:**
    - (2) Despite paragraphs (1)(a) and (b), an alternative mutual fund or a non-redeemable investment fund may borrow cash or provide a security interest over any of its portfolio assets if each of the following apply:
      - (a) any borrowing of cash is
        - (i) from an entity described in section 6.2 or 6.3, and
        - (ii) if the lender is an affiliate or associate of the investment fund manager of the alternative mutual fund or non-redeemable investment fund, under a

borrowing agreement approved by the independent review committee as required under section 5.2 of NI 81-107;

- (b) the borrowing agreement is in accordance with normal industry practice and on standard commercial terms for the type of transaction;
- (c) the value of cash borrowed, when aggregated with the value of all outstanding borrowing by the alternative mutual fund or non-redeemable investment fund, does not exceed 50% of the alternative mutual fund or non-redeemable investment fund's net asset value..

**11. Subsection 2.6.1(1) is amended**

- (a) **by replacing "A mutual fund" with "An investment fund",**
- (b) **in subparagraph (b)(i), by replacing "mutual fund" with "investment fund", and**
- (c) **by replacing paragraph (c) with the following:**
  - (c) at the time the investment fund sells the security short,
    - (i) the investment fund has borrowed or arranged to borrow from a borrowing agent the security that is to be sold under the short sale,
    - (ii) if the investment fund is a mutual fund, other than an alternative mutual fund, the aggregate market value of the securities of the issuer of the securities sold short by the mutual fund does not exceed 5% of the net asset value of the mutual fund,
    - (iii) if the investment fund is a mutual fund, other than an alternative mutual fund, the aggregate market value of the securities sold short by the mutual fund does not exceed 20% of the net asset value of the mutual fund,
    - (iv) if the investment fund is an alternative mutual fund or a non-redeemable investment fund, the aggregate market value of the securities of the issuer of the securities sold short by the investment fund, other than government securities sold short by an alternative mutual fund or non-redeemable investment fund, does not exceed 10% of the net asset value of the investment fund, and

- (v) if the investment fund is an alternative mutual fund or a non-redeemable investment fund, the aggregate market value of the securities sold short by the investment fund does not exceed 50% of the net asset value of the investment fund..

12. **Subsection 2.6.1(2) is amended by replacing “A mutual fund” with “A mutual fund, other than an alternative mutual fund,” and by replacing “all” with “the” after “aggregate market value of”.**

13. **Subsection 2.6.1(3) is amended by replacing “A mutual fund” with “A mutual fund ,other than an alternative mutual fund,”.**

14. **The Instrument is amended by adding the following section:**

#### **2.6.2 Total Borrowing and Short Sales**

- (1) Despite sections 2.6 and 2.6.1, an investment fund must not borrow cash or sell securities short if, immediately after entering into a cash borrowing or short selling transaction, the aggregate value of cash borrowed combined with the aggregate market value of the securities sold short by the investment fund would exceed 50% of the investment fund’s net asset value.
- (2) Despite sections 2.6 and 2.6.1, if the aggregate value of cash borrowed combined with the aggregate market value of the securities sold short by the investment fund exceeds 50% of the investment fund’s net asset value, the investment fund must, as quickly as is commercially reasonable, take all necessary steps to reduce the aggregate value of cash borrowed combined with the aggregate market value of securities sold short to 50% or less of the investment fund’s net asset value..

15. **Section 2.7 is amended**

(a) **in subsection (1) by replacing “A mutual fund” with “An investment fund”, by adding “forward” before “contract” in paragraphs (1)(b) and (c) , by replacing “rating.” with “rating;”, in paragraph (c) and by adding the following paragraph:**

- (d) the option, debt-like security, swap or forward contract is a cleared specified derivative.,

(b) **by replacing subsection (2) with the following:**

- (2) If the credit rating of an option, debt-like security, swap or forward contract, or the credit rating of the equivalent debt of the writer or guarantor of the option, debt-like security, swap or forward

contract, falls below the level of designated rating while the option, debt-like security, swap or forward contract is held by an investment fund, the investment fund must take the steps that are reasonably required to close out its position in the option, debt-like security, swap or forward contract in an orderly and timely fashion, unless either of the following applies:

- (a) the option is a clearing corporation option;
- (b) the option, debt-like security, swap or forward contract is a cleared specified derivative.,

(c) ***in subsection (3) by replacing “a mutual fund” with “an investment fund”,***

(d) ***by replacing subsection (4) with the following:***

(4) The mark-to-market value of the exposure of an investment fund under its specified derivatives positions with any one counterparty, calculated in accordance with subsection (5), must not exceed, for a period of 30 days or more, 10% of the net asset value of the investment fund unless either of the following applies:

- (a) the specified derivative is a cleared specified derivative;
- (b) the equivalent debt of the counterparty, or of a person or company that has fully and unconditionally guaranteed the obligations of the counterparty in respect of the specified derivative, has a designated rating.,

(e) ***in subsection (5) by replacing “a mutual fund” with “an investment fund,” and by replacing “the mutual fund” with “the investment fund” wherever it occurs, and***

(f) ***by adding the following subsection:***

(6) Subsections (1), (2) and (3) do not apply to an alternative mutual fund or a non-redeemable investment fund..

**16. Section 2.8 is amended by adding the following subsection:**

(0.1) This section does not apply to an alternative mutual fund..

**17. The Instrument is amended by adding the following section:**

### **2.9.1 Aggregate Exposure to Borrowing, Short Selling and Specified Derivatives**

(1) An alternative mutual fund or non-redeemable investment fund's aggregate exposure to cash borrowing, short selling and specified

derivatives transactions must not exceed 300% of the fund's net asset value.

- (2) For the purposes of subsection (1), an alternative mutual fund or non-redeemable investment fund's aggregate exposure is the sum of the following, divided by the fund's net asset value:
  - (a) the aggregate value of the alternative mutual fund's or non-redeemable investment fund's outstanding indebtedness under any borrowing agreements to which subsection 2.6(2) applies,
  - (b) the aggregate market value of all securities sold short by the alternative mutual fund or non-redeemable investment fund as permitted by section 2.6.1, and
  - (c) the aggregate notional amount of the alternative mutual fund's or non-redeemable investment fund's specified derivatives positions, minus the aggregate notional amount of the specified derivative positions that are hedging transactions.
- (3) For the purposes of this section the alternative mutual fund or non-redeemable investment fund must include in its calculation its proportionate share of the assets of any underlying investment fund for which a similar calculation is required.
- (4) An alternative mutual fund or non-redeemable investment fund must determine its aggregate exposure in accordance with subsection (2) as of the close of business of each day on which it calculates a net asset value.
- (5) If the alternative mutual fund or non-redeemable investment fund's aggregate exposure as determined in accordance with subsection (2) exceeds 300% of its net asset value, the alternative mutual fund or non-redeemable investment fund must, as quickly as is commercially reasonable, take all necessary steps to reduce the aggregate exposure to 300% its net asset value or less..

**18. Section 2.11 is amended by adding the following subsection:**

(0.1) This section does not apply to an alternative mutual fund..

**19. Section 6.2 is amended in paragraph 3.(a) by deleting "that have been made public,".**

**20. Section 6.3 is amended in paragraph 3.(a) by deleting "that have been made public,".**

**21. Subsection 6.8(1) is amended**

- (a) **by adding** "Borrowing," **before** "Derivatives" **in the heading**,
- (b) **by replacing** "futures or" **with** "futures",
- (c) **by adding** "or cleared specified derivatives with a member of a regulated clearing agency or" **after** "standardized futures",
- (d) **by adding** "member or" **after** "margin already held by the", **and**
- (e) **by replacing** "10 percent" **with** "10%".

**22. Subsection 6.8(2) is amended**

- (a) **by adding** "member of a regulated clearing agency or with a" **after** "portfolio assets with a", **by replacing** "or" **with** "," **after** "options on futures" **and by adding** "or cleared specified derivatives" **after** "standardized futures",
- (b) **in paragraph (a) by replacing** "in the case of standardized futures and options on futures, the" **with** "the member or", **by adding** "regulated clearing agency," **before** "futures exchange", **by deleting** ", in the case of clearing corporation options, is a member of a", **by replacing** "either case" **with** "any case" **and by replacing** ";" **with** ":",
- (c) **in paragraph (b) by adding** "member or" **before** "dealer", **by deleting** "that have been made public" **and by replacing** ";" **with** ":", **and**
- (d) **in paragraph (c) by adding** "member or" **before** "dealer", **and by replacing** "10 percent" **with** "10%".

**23. Section 6.8 is amended by adding the following subsection:**

- (3.1) An investment fund may deposit with its lender, portfolio assets over which it has granted a security interest in connection with a borrowing agreement to which section 2.6 applies..

**24. Subsection 6.8(4) is amended by replacing** "(2) or (3)" **with** "(2), (3) or (3.1)".

**25. Subsection 6.8(5) is amended by adding** "borrowing," **before** "securities lending".

**26. Section 6.8.1 is amended**

- (a) **by replacing subsection (1) with the following:**

- (1) Unless the borrowing agent is the investment fund's custodian or sub-custodian, if an investment fund deposits portfolio assets with a borrowing agent as security in connection with a short sale of securities, the market value of portfolio assets deposited with the borrowing agent must not, when aggregated with the market value of portfolio assets already held by the borrowing agent as security for outstanding short sales of securities by the investment fund,
  - (a) in the case of a mutual fund, other than an alternative mutual fund, exceed 10% of the net asset value of the mutual fund at the time of deposit, and
  - (b) in the case of an alternative mutual fund or a non-redeemable investment fund, exceed 25% of the net asset value of the alternative mutual fund or non-redeemable investment fund at the time of deposit., **and**

**(b) in paragraph (3)(b) by deleting "that have been made public".**

**27. Section 7.1 is amended**

**(a) by renumbering it as subsection 7.1(1),**

**(b) in subsection (1) by replacing "A mutual fund" with "A mutual fund, other than an alternative mutual fund,", and by replacing ", unless" with "unless", and**

**(c) by adding the following subsection:**

- (2) An alternative mutual fund must not pay, or enter into arrangements that would require it to pay, and must not sell securities of an alternative mutual fund on the basis that an investor would be required to pay, a fee that is determined by the performance of the alternative mutual fund unless
  - (a) the payment of the fee is based on the cumulative total return of the alternative mutual fund for the period that began immediately after the last period for which the performance fee was paid, and
  - (b) the method of calculating the fee is described in the alternative mutual fund's prospectus..

**28. Paragraph 9.1.1(b) is amended by adding "short" before "position".**

**29. Section 10.1 is amended by adding the following subsection:**

- (2.1) If disclosed in its prospectus, an alternative mutual fund may include, as part of the requirements contemplated in subsection (2), a provision that securityholders of the alternative mutual fund may not redeem their securities for a period up to 6 months after the date on which the receipt is issued for the initial prospectus of the alternative mutual fund..

**30. Section 10.3 is amended by adding the following subsection:**

- (5) Despite subsection (1), an alternative mutual fund may redeem securities of the alternative mutual fund at a price that is equal to the net asset value for those securities determined on the first or second business day after the date of receipt by the alternative mutual fund of the redemption order if
- (a) the alternative mutual fund has established a policy providing for the redemption price to be calculated on such a basis, and
  - (b) the policy has been disclosed in the alternative mutual fund's prospectus before the policy's implementation..

**31. Subsection 10.4(1.1) is amended by adding "or an alternative mutual fund or" after "continuous distribution".**

**32. Subsection 15.13(2) is amended by replacing "a commodity pool" with "an alternative mutual fund" wherever it occurs and by deleting "as defined in National Instrument 81-104 Commodity Pools".**

**33. Appendix A – Futures Exchanges for the Purpose of Subsection 2.7(4) – Derivative Counterparty Exposure Limits is repealed.**

**Transition**

34. If a commodity pool, as that term was defined in National Instrument 81-104 *Commodity Pools* on January 2, 2019, has filed a prospectus for which a receipt was granted on or before that date, this Instrument does not apply to that commodity pool until July 4, 2019.

**Effective Date**

35. This Instrument comes into force on January 3, 2019.

## ANNEX C-2

FINANCIAL AND  
CONSUMER SERVICES  
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### CHANGES TO COMMENTARY TO NATIONAL INSTRUMENT 81-102 INVESTMENT FUNDS

1. ***National Instrument 81-102 Investment Funds is changed by this document.***
2. ***The Commentary to Item 1 of Appendix F – Investment Risk Classification Methodology is changed by adding the following after Commentary (2):***
  - (3) *In deciding whether to exercise the discretion to increase a mutual fund's investment risk level as permitted in subsection (2) above, consideration should be given as to whether the standard deviation calculation applied under the Investment Risk Classification Methodology may result in a risk level that is below the manager's own expectations for the mutual fund. This can occur, for example, when a mutual fund employs investment strategies that produce an atypical or non-normal distribution of performance results. In such circumstances mutual funds are encouraged to consider supplementing the Investment Risk Classification Methodology with other factors or risk metrics in order to determine whether it would be appropriate to make an upward adjustment of the mutual fund's risk level to better reflect the features of the mutual fund..*
3. This change becomes effective on January 3, 2019.

## ANNEX C-3

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### CHANGES TO COMPANION POLICY 81-102CP TO NATIONAL INSTRUMENT 81-102 INVESTMENT FUNDS

1. *Companion Policy 81-102CP to National Instrument 81-102 Investment Funds is changed by this Document.*
2. *Part 2 is changed by adding the following sections:*

#### 2.01 “alternative mutual fund”

- (1) This term replaced the term “commodity pool” that was previously defined under the National Instrument 81-104 *Commodity Pool* (NI 81-104). Mutual funds that were commodity pools under NI 81-104 are deemed to be alternative mutual funds under this Instrument.
- (2) The definition of “alternative mutual fund” contemplates that the fund’s fundamental investment objectives will reflect those features that distinguish the alternative mutual fund from more conventional mutual funds. Therefore if an existing mutual were to convert to an alternative mutual fund, we would expect such a change to necessitate changes to the mutual fund’s investment objectives that would require securityholder approval under Part 5 of the Instrument.
- (3) The Instrument does not mandate a naming convention for mutual funds. However, it is our view that a mutual fund with the word “alternative” in its name could be misleading or cause confusion in the marketplace if that mutual fund is not an alternative mutual fund. We would generally expect that the only mutual funds that would use that term in their name would be alternative mutual funds.

**2.3.1 “cleared specified derivative”** – the definition of “cleared specified derivative” is intended to apply to derivatives transactions that take place through the facilities of a “regulated clearing agency” as defined in National Instrument 94-101 *Mandatory Central Clearing of Derivatives*. The Instrument provides exemptions from certain of the provisions governing the use of cleared specified derivatives by investment funds. These exemptions are intended to facilitate the use of the clearing infrastructure in compliance with international

requirements for mandatory clearing of derivatives, although the exemptions also apply in respect of cleared specified derivatives that are not subject to mandatory clearing obligations..

3. **Subsection (1) of Section 3.3.1 is changed by deleting** “Although section 2.4 of the Instrument does not apply to non-redeemable investment funds,” **and by replacing** “the Canadian securities regulatory authorities” **with** “The Canadian securities regulatory authorities”.

4. **Part 3 is changed by adding the following section:**

**3.6.1 Cash Borrowing** – Subsection 2.6(2) of the Instrument permits an alternative mutual fund or non-redeemable investment fund to borrow cash for investment purposes (including investing on margin) from an entity that meets the criteria of a fund custodian or subcustodian under section 6.2 or 6.3, and can include the fund’s own custodian or subcustodian. This provision also permits a fund to borrow cash from a lender that is an affiliate or associate of the fund’s investment fund manager provided independent review committee approval is granted..

5. **Section 4.3 is changed by replacing it with the following:**

#### **4.3 Leveraging**

- (1) The investment restrictions in the Instrument are in part intended to prevent the use of specified derivatives for the purpose of leveraging the assets of a mutual fund. The definition of “hedging” prohibits leveraging with respect to specified derivatives used for hedging purposes. The provisions of subsection 2.8(1) of the Instrument restrict leveraging with respect specified derivatives used for non-hedging purposes.
- (2) Alternative mutual funds however, are exempted from section 2.8 and are instead subject to the restrictions on the use of leverage set out in section 2.9.1 of the Instrument, which limit exposure to certain sources of leverage to no more than 300% of an alternative mutual fund’s net asset value. The calculation in section 2.9.1 requires an investment fund to determine the notional amount of its specified derivatives positions. While the Instrument does not define notional amount, in this context we would expect it to be determined in regards to the value of the underlying reference asset, as if the specified derivative position were converted into the equivalent position in the underlying reference asset at the time of the calculation..

6. The changes become effective on January 3, 2019.

## ANNEX D-1

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### AMENDMENTS TO NATIONAL INSTRUMENT 81-104 COMMODITY POOLS

1. ***National Instrument 81-104 Commodity Pools is amended by this Instrument.***
2. ***The title is amended by replacing “NATIONAL INSTRUMENT 81-104 COMMODITY POOLS” with “NATIONAL INSTRUMENT 81-104 ALTERNATIVE MUTUAL FUNDS”.***
3. ***Subsection 1.1(1) is amended***
  - (a) ***by repealing the definitions of “commodity pool”, “independent review committee”, and “precious metals fund”,***
  - (b) ***by adding “and” at the end of the definition of “Derivatives Fundamentals Course”,***
  - (c) ***by deleting “and” at the end of the definition of “mutual fund restricted individual”, and***
  - (d) ***by adding the following definition:***

“alternative mutual fund” has the same meaning as in section 1.1 of NI 81-102;.
4. ***Section 1.2 is amended***
  - (a) ***in paragraph (a) by replacing “a commodity pool” with “an alternative mutual fund”, and in subparagraph (i) by replacing “commodity pool” with “alternative mutual fund”, and***
  - (b) ***in paragraph (b) by replacing “a commodity pool” with “an alternative mutual fund”, and by deleting “or pertaining to the filing of a prospectus to which subsection 3.2(1) applies”.***
5. ***Section 1.3 is amended***
  - (a) ***in subsection (1) by replacing “a commodity pool” with “an alternative mutual fund”, and by replacing “commodity pool” with “alternative mutual fund”, and***

(b) *by repealing subsection (2).*

6. *Part 2 is repealed.*
7. *Part 3 is repealed.*
8. *Section 4.1 is amended by replacing “a commodity pool” with “an alternative mutual fund” wherever it occurs, and by replacing “commodity pools” with “alternative mutual funds” wherever it occurs.*
9. *Part 5 is repealed.*
10. *Part 6 is repealed.*
11. *Part 8 is repealed.*
12. *Section 11.2 is repealed.*
13. This Instrument comes into force on January 3, 2019.

ANNEX D-2

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WITHDRAWAL OF  
COMPANION POLICY 81-104CP TO  
NATIONAL INSTRUMENT 81-104 *COMMODITY POOLS*

1. *Companion Policy 81-104CP to National Instrument 81-104 Commodity Pools is withdrawn.*
2. This document becomes effective on January 3, 2019.

## ANNEX E

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### AMENDMENTS TO NATIONAL INSTRUMENT 41-101 *GENERAL PROSPECTUS REQUIREMENTS*

1. ***National Instrument 41-101 General Prospectus Requirements is amended by this Instrument.***
2. ***Section 1.1 is amended by adding the following definition:***

“alternative mutual fund” has the same meaning as in section 1.1 of NI 81-102;.
3. ***Form 41-101F2 Information Required in an Investment Fund Prospectus is amended***
  - (a) ***by replacing “commodity pool” in Item 1.3(1) with “alternative mutual fund”,***
  - (b) ***by adding the following after Item 1.3(3):***
    - (4) If the mutual fund to which the prospectus pertains is an alternative mutual fund, include a statement explaining that the fund is permitted to invest in asset classes or use investment strategies that are not permitted for other types of mutual funds and explain how exposure to the asset classes or the adoption of the investment strategies may affect investors’ risk of losing money on their investment in the fund.,
  - (c) ***by replacing “commodity pool” in Item 1.11(3) with “alternative mutual fund”,***
  - (d) ***by repealing Item 1.12,***
  - (e) ***by replacing paragraph (e) of Item 3.3(1) with the following:***
    - (e) the use of leverage, including all of the following:
      - (i) the maximum aggregate exposure to borrowing, short selling and specified derivatives the investment fund is permitted to have, expressed as a percentage calculated in accordance with section 2.9.1 of NI 81-102,

- (ii) a brief description of any other restrictions on the investment fund's use of leverage, and
- (iii) a brief description of any limits that apply to each source of leverage.,

**(f) by adding the following after instruction (3) to Item 5:**

- (4) *If the mutual fund is an alternative mutual fund, describe the features of the mutual fund that cause it to fall within the definition of "alternative mutual fund" in NI 81-102. If those features involve the use of leverage, disclose the sources of leverage (i.e., borrowing, short selling, use of derivatives) the alternative mutual fund is permitted to use and the maximum aggregate exposure to those sources of leverage the alternative mutual fund is permitted to have, as a percentage calculated in accordance with section 2.9.1 of NI 81-102.,*

**(g) by replacing paragraph (b) of Item 6.1(1) with the following:**

- (b) the use of leverage, including both of the following:
  - (i) a brief description of any restrictions on the investment fund's use of leverage;
  - (ii) a brief description of any limits that apply to each source of leverage.,

**(h) by adding the following after Item 6.1(6):**

- (7) In the case of an investment fund that borrows cash in accordance with subsection 2.6 (2) of NI 81-102,
  - (a) state that the investment fund is permitted to borrow cash and the maximum amount the fund is permitted to borrow, and
  - (b) briefly describe how borrowing will be used in conjunction with other strategies of the investment fund to achieve its investment objectives and the material terms of the borrowing arrangements.,

**(i) by adding the following after Item 19.11**

**19.12 Lender**

- (1) State the name of each person or company that has entered into an agreement to lend money to the investment fund or provides a line of

credit or similar lending arrangement to the investment fund.

- (2) State whether the person or company named in subsection (1) is an affiliate or associate of the manager of the investment fund., **and**

- (j) **by replacing “a commodity pool” in Item 23.1(f) with “an alternative mutual fund”.**

**4. Form 41-101F4 Information Required in an ETF Facts Document is amended**

- (a) **by replacing the instructions to Item 1 of Part 1 with the following:**

*INSTRUCTIONS:*

- (1) *The date for an ETF facts document that is filed with a preliminary prospectus or final prospectus must be the date of the preliminary prospectus or final prospectus, respectively. The date for an ETF facts document that is filed with a pro forma prospectus must be the date of the anticipated final prospectus. The date for an amended ETF facts document must be the date on which it is filed.*

- (2) *If the investment objectives of the ETF are to track a multiple (positive or negative) of the daily performance of a specified underlying index or benchmark, provide textbox disclosure in bold type using wording substantially similar to the following:*

This ETF is an alternative mutual fund. It is permitted to invest in asset classes or use investment strategies that are not permitted for other types of mutual funds.

This ETF is highly speculative. It uses leverage which magnifies gains and losses. It is intended for use in daily or short-term trading strategies by sophisticated investors. If you hold this ETF for more than one day, your return could vary considerably from the ETF's daily target return. Any losses may be compounded. Don't buy this ETF if you are looking for a longer-term investment.

- (3) *If the investment objectives of the ETF are to track the inverse performance of a specified underlying index or benchmark, provide textbox disclosure in bold type using wording substantially similar to the following:*

This ETF is an alternative mutual fund. It is permitted to invest in asset classes or use investment strategies that are not permitted for other types of mutual funds.

This ETF is highly speculative. It is intended for use in daily or short-term trading strategies by sophisticated investors. If you hold this ETF for more than one day, your return could vary considerably from the ETF's daily target return. Any losses may be compounded. Don't buy this ETF if you are looking for a longer-term investment.

- (4) *If the ETF is an alternative mutual fund and Instruction (2) or (3) does not apply, provide textbox disclosure in bold type using wording substantially similar to the following:*

This ETF is an alternative mutual fund. It has the ability to invest in asset classes or use investment strategies that are not permitted for other types of mutual funds.

The specific features that differentiate this fund from other types of mutual funds include: *[list the asset classes the alternative mutual fund invests in and the investment strategies used by the alternative mutual fund that cause it to fall within the definition of "alternative mutual fund"]*

*[Explain how the listed features may affect investors' risk of losing money on their investment in the alternative mutual fund],*

- (b) by adding the following after Item 3(1) of Part 1:**

- (1.1) For an alternative mutual fund that uses leverage

(a) disclose the sources of leverage, and

(b) disclose the maximum aggregate exposure to those sources of leverage the alternative mutual fund is permitted to have.,  
**and**

- (c) by adding the following after subsection (3) of the instructions to Item 3 of Part 1:**

- (3.1) *The alternative mutual fund's aggregate exposure to sources of leverage must be expressed as a percentage calculated in accordance with section 2.9.1 of NI 81-102..*

## Transition

5. If a commodity pool, as that term was defined in National Instrument 81-104 *Commodity Pools* on January 2, 2019, has filed a prospectus for which a receipt was granted on or before that date, this Instrument does not apply to the commodity pool until July 4, 2019.

## Effective Date

6. This Instrument comes into force on January 3, 2019.

## ANNEX F

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### AMENDMENTS TO NATIONAL INSTRUMENT 81-101 MUTUAL FUND PROSPECTUS DISCLOSURE

1. ***National Instrument 81-101 Mutual Fund Prospectus Disclosure is amended by this Instrument.***
2. ***Section 1.1 is amended by repealing the definitions of “commodity pool” and “precious metals fund”.***
3. ***Section 1.3 is amended by adding “or” at the end of paragraph (a) and by repealing paragraph (b).***
4. ***Section 5.1 is amended by adding the following subsection:***
  - (4) Despite subsection (1), a simplified prospectus for an alternative mutual fund must not be consolidated with a simplified prospectus of another mutual fund if the other mutual fund is not an alternative mutual fund..
5. ***Subsection 6.1(3) is amended by adding “Alberta and” before “Ontario”.***
6. ***Form 81-101F1 Contents of Simplified Prospectus is amended***
  - (a) ***by adding the following under the general instructions:***

(14.1) Subsection 5.1(4) of National Instrument 81-101 states that a simplified prospectus of an alternative mutual fund must not be consolidated with a simplified prospectus of another mutual fund that is not an alternative mutual fund.,
  - (b) ***by adding the following after Item 1.1(2) of Part A:***

(2.1) If the mutual fund to which the simplified prospectus pertains is an alternative mutual fund, indicate that fact on the front cover.,
  - (c) ***by adding the following after Item 1.2(2) of Part A:***

(2.1) If the mutual funds to which the document pertains are alternative mutual funds, indicate that fact on the front cover.,

**(d) by adding the following after instruction (3) to Item 6 of Part B:**

(4) *If the mutual fund is an alternative mutual fund, describe the features of the mutual fund that cause it to fall within the definition of "alternative mutual fund" in National Instrument 81-102 Investment Funds. If those features include the use of leverage, disclose the sources of leverage (e.g., cash borrowing, short selling, use of derivatives) that the fund is permitted to use as well as the maximum aggregate exposure to those sources of leverage the alternative mutual fund is permitted to have, as a percentage calculated in accordance with section 2.9.1 of National Instrument 81-102 Investment Funds.,*

**(e) by adding the following after Item 7(10) of Part B:**

(11) *In the case of an alternative mutual fund that borrows cash pursuant to subsection 2.6 (2) of National Instrument 81-102 Investment Funds*

(a) *state that the alternative mutual fund is permitted to borrow cash and the maximum amount the fund is permitted to borrow, and*

(b) *briefly describe how borrowing will be used in conjunction with other strategies of the alternative mutual fund to achieve its investment objectives.,*

**(f) by adding the following after Item 9(2) of Part B:**

(2.1) *In the case of an alternative mutual fund, include disclosure explaining that the alternative mutual fund is permitted to invest in asset classes and use investment strategies that are not permitted for other types of mutual funds and explain how these investment strategies could affect investors' risk of losing money on their investment in the fund.,*

**(g) by deleting "and" at the end of paragraph (b) of Item 9(7) of Part B,**

**(h) by replacing "." at the end of paragraph (c) of Item 9(7) of Part B with "; and", and**

**(i) by adding the following after paragraph (c) of Item 9(7) of Part B:**

(d) *borrowing arrangements..*

**7. Form 81-101F2 Contents of Annual Information Form is amended**

**(a) by adding the following after Item 1.1(2):**

- (2.1) If the mutual fund to which the annual information form pertains is an alternative mutual fund, indicate that fact on the front cover.,  
**and**

**(b) by adding the following after Item 10.9.1:**

**10.9.2 Cash Lender**

- (1) In the case of an alternative mutual fund, state the name of each person or company that has entered into an agreement to lend money to the alternative mutual fund or provides a line of credit or similar lending arrangement to the alternative mutual fund.
- (2) State whether any person or company named in subsection (1) is an affiliate or associate of the manager of the alternative mutual fund..

**8. Form 81-101F3 Contents of Fund Facts Document is amended**

**(a) by deleting “and” at the end of paragraph (e) of Item 1 of Part I,**

**(b) by replacing “risk.” with “risk; and” at the end of paragraph (f) of Item 1 of Part I,**

**(c) by adding the following after paragraph (f) of Item 1 of Part I:**

- (g) if the fund facts document pertains to an alternative mutual fund, textbox disclosure using wording substantially similar to the following:

This mutual fund is an alternative mutual fund. It is permitted to invest in asset classes or use investment strategies that are not permitted for other types of mutual funds.

The specific strategies that differentiate this fund from other types of mutual funds include: *[list the features of the alternative mutual fund that cause it to fall within the definition of “alternative mutual fund” in National Instrument 81-102 Investment Funds].*

*[Explain how the listed investment strategies could affect investors’ risk of losing money on their investment in the alternative mutual fund.],*

**(d) by adding the following after Item 3(1) of Part I:**

- (1.1) In the case of an alternative mutual fund that uses leverage,

- (a) disclose the sources of leverage, and
  - (b) disclose the maximum aggregate exposure to those sources of leverage the alternative mutual fund is permitted to have., **and**
- (e) **by adding the following after subsection (3) of the instructions to Item 3 of Part I:**
- (3.1) *The alternative mutual fund's aggregate exposure to the sources of leverage must be expressed as a percentage calculated in accordance with section 2.9.1 of National Instrument 81-102 Investment Funds..*

#### **Transition**

- 9. If a commodity pool, as that term was defined in National Instrument 81-104 *Commodity Pools* on January 2, 2019, has filed a prospectus for which a receipt was granted on or before that date, this Instrument does not apply to that commodity pool until July 4, 2019.

#### **Effective Date**

- 10. This Instrument comes into force on January 3, 2019.

## ANNEX G

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### AMENDMENTS TO NATIONAL INSTRUMENT 81-106 *INVESTMENT FUND CONTINUOUS DISCLOSURE*

1. ***National Instrument 81-106 Investment Fund Continuous Disclosure is amended by this Instrument.***
2. ***Subsection 1.3(3) is amended by deleting “National Instrument 81-104 Commodity Pools or” and by replacing “those Instruments” with “that Instrument”.***
3. ***The Instrument is amended by adding the following section:***

#### **3.12 Disclosure of Use of Leverage**

- (1) An investment fund that uses leverage must disclose the following information in its financial statements:
    - (a) a brief explanation of the sources of leverage including cash borrowing, short selling or use of specified derivatives, used during the reporting period covered by the financial statements,
    - (b) the lowest and highest level of the aggregate exposure to those sources of leverage in the period, and
    - (c) a brief explanation of the significance to the investment fund of the lowest and highest levels of the aggregate exposure to those sources of leverage.
  - (2) For the purposes of subsection (1), an investment fund must calculate its aggregate exposure to those sources of leverage in accordance with section 2.9.1 of National Instrument 81-102 *Investment Funds*.
4. ***Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance is amended***
    - (a) ***in Item 2.3 of Part B by adding the following subsection:***
      - (3) An investment fund that uses leverage must disclose,

- (a) a brief explanation on the sources of leverage including cash borrowing, short selling or use of specified derivatives, used during the reporting period,
- (b) the lowest and highest level of aggregate exposure to those sources of leverage in the period, and
- (c) a brief explanation of the significance of the lowest and highest levels of aggregate exposure to those sources of leverage to the investment fund including the impact of the use of specified derivatives for hedging purposes., **and**

**(b) by replacing the Instruction to Item 2.3 of Part B with the following:**

**INSTRUCTIONS:**

- (1) *Explain the nature of and reasons for changes in the investment fund's performance. Do not only disclose the amount of change in a financial statement item from period to period. Avoid the use of boilerplate wording. Your discussion must be prepared in a manner that will assist a reasonable reader to understand the significant factors that have affected the investment fund's performance.*
- (2) *For the purposes of the disclosure required in Item 2.3(3)(b), an investment fund must calculate its aggregate exposure to sources of leverage in accordance with section 2.9.1 of National Instrument 81-102 Investment Funds.*
- (3) *In discussing the impact of the use of specified derivatives for hedging purposes on the investment fund's calculation of its aggregate exposure to sources of leverage, the fund must discuss by how much the aggregate exposure was reduced by subtracting the notional value of the fund's specified derivatives positions that are hedging transactions as is contemplated in paragraph 2.9.1(2)(c) of National Instrument 81-102 Investment Funds..*

5. This Instrument comes into force on January 3, 2019.

## ANNEX H-1

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### AMENDMENTS TO NATIONAL INSTRUMENT 81-107 *INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS*

1. *National Instrument 81-107 Independent Review Committee for Investment Funds is amended by this Instrument.*
2. *Subsection 5.2(1) is amended*
  - (a) *in paragraph (b) by deleting “or”,*
  - (b) *in paragraph (c) replacing “.” with “; or”, and*
  - (c) *by the adding the following paragraph:*
  - (d) a transaction in which an investment fund intends to borrow cash from a person or company that is an associate or affiliate of the investment fund manager..
3. This Instrument comes into force on January 3, 2019.

## ANNEX H-2

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### CHANGES TO COMMENTARY TO NATIONAL INSTRUMENT 81-107 INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS

1. *The Commentary to National Instrument 81-107 Independent Review Committee for Investment Funds is changed by this Document.*
2. *Section 1 of the Commentary to Section 5.2 of the Instrument is changed by adding "Part 2 and" after "Part 6 of this Instrument or".*
3. This change becomes effective on January 3, 2019.



AMENDMENTS TO  
MULTILATERAL INSTRUMENT 11-102 *PASSPORT SYSTEM*

1. *Multilateral Instrument 11-102 Passport System is amended by this Instrument.*
2. *Appendix D – Equivalent Provisions is amended by replacing “Commodity Pools – NI 81-104” with “Alternative Mutual Funds – NI 81-104”.*
3. This Instrument comes into force on January 3, 2019.