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

Me Anne-Marie Beaudoin, Corporate Secretary
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The Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

Dear Sirs:

RE: Proposed Amendments to National Instrument 81-102 Mutual Funds, Companion Policy 81-102CP Mutual Funds and Related Consequential Amendments

We are writing to provide comments on behalf of the Members of The Investment Funds Institute of Canada ("IFIC" or "we") with respect to the CSA's Proposed Amendments to National Instrument 81-102 Mutual Funds ("NI 81-102"), Companion Policy 81-102CP Mutual Funds ("81-102 CP") and Related Consequential Amendments (collectively, the "Proposals").

As a general comment, our Members believe that the CSA's overall objective to create more consistency in the oversight, governance and disclosure requirements of the range of investment funds is a good one.

As we understand the Proposals, the CSA is proposing three key elements in this phase of its rule modernization initiative:

1. Closed-end funds that choose to apply NI 81-102 investment restrictions will be regulated under NI 81-102, with some minor differences, and are proposed to be referred to as "non-redeemable investment funds";
2. Proposals relating to the provisions in NI 81-102 governing the use of securities lending, repurchase and reverse repurchase transactions and disclosure of revenues; and
3. Closed- and open-end funds that choose not to adopt the investment restrictions in NI 81-102 will be regulated within a new "alternative fund" framework which will be incorporated into NI 81-104; it is proposed that these funds will be referred to as "alternative funds".

We set out below our Members' concerns with the Proposals as they relate to conventional open-ended mutual funds. We are not commenting on the proposed changes from the perspective of managers and distributors of non-redeemable investment funds or alternative funds – individual IFIC Members that offer such products will provide their views in separate comment letters.

A. Proposed Amendments to NI 81-102

Inclusion of Non-Redeemable Investment Funds in NI 81-102

We are supportive of the CSA's decision to move towards greater consistency in the regulatory regime that applies to conventional open-ended mutual funds and comparable closed end funds. Generally we think it makes sense that the same restrictions should apply to all funds that will be governed by NI 81-102, except where the nature of the type of fund requires different treatment. In this regard, the CSA is considering certain exceptions regarding the restrictions on investing in illiquid assets and the use of borrowing.

The Proposals request comment on whether the application of less restrictive illiquid investment and borrowing restrictions for non-redeemable investment funds is appropriate given their different liquidity needs as compared to open-ended mutual funds. Managers of conventional open-ended mutual funds are effective at managing liquidity and risk in their portfolios. Some of our Members believe that there is little practical difference between non-redeemable funds and open-ended mutual funds in their need to generate liquidity in order to satisfy redemption requests, despite differences in frequency. The CSA should consider whether these frequency differences are a sufficient basis on which to apply different restrictions in these areas.

Investment Fund Use of Securities Lending, Repurchase and Reverse Repurchase Agreements

Our Members do not typically use repurchase and reverse repurchase strategies within their conventional mutual funds and do not view the use of securities lending to be a significant investment strategy within their conventional mutual funds; such activity is not usually material to a fund's operations and does not generate a material amount of any fund's income.

Given that these activities are immaterial, requiring the very detailed disclosures that the CSA proposes is of little value to investors. The general disclosures that are currently required appropriately inform investors that a fund engages in securities lending and how, as well as the limits on the fund's ability to enter into the transactions. We do not believe that the scope of securities lending activity would influence an investor's decision to buy, sell or continue to hold securities in a fund.

One of the primary aims of continuous disclosure documents, such as simplified prospectuses, management reports of fund performance and financial statements, is to ensure consistency

and comparability for investors across all funds. These documents must follow a prescribed form to ensure that comparability is maintained. Requiring disclosure of detailed financial components of a fund's securities lending activities will not meaningfully inform or benefit investors, especially since a fund's previous lending activities and revenues may not be repeated and are not indicative of future activities and revenues. These variables fluctuate from fund to fund and from market cycle to market cycle. While there may be a reasonably constant flow of activity in the general lending of securities, there are also unique market and corporate events that trigger significantly higher demand for securities lending for short periods, such as during dividend season. The proposed disclosures in the management reports of fund performance will not be meaningful and may even be misleading given these variables.

We consider it would be misleading and inconsistent with the accepted accounting treatment of securities lending revenue as reported on a fund's financial statements to report such revenue as a gross amount from which is deducted, as an expense, the portion retained by the agent. A fund is not entitled to the gross amount of securities lending revenues - the lending agent is entitled to its share before remitting the net revenue to the fund. It is only appropriate to disclose the actual amount earned by the fund, a figure that is already disclosed in a fund's financial statements under existing requirements. The portion that is retained by the lending agent is neither a cost of operating the fund nor a cost of the fund's trading activities. It is, therefore, misleading to include such amounts in a fund's MER or TER. Furthermore, to calculate the revenue in one way for purposes of the financial statements, and in another way for purposes of the management reports of fund performance, as proposed, will produce conflicting disclosure in these documents that investors will be unable to reconcile.

We further believe that the current disclosure requirements are sufficient and there would be no incremental value to providing more detailed disclosure. This is particularly true given how immaterial these activities are to fund operations; the lending revenues may not justify the cost of collecting and disclosing such information.

Additional disclosure of the identity of the lending agent is not required since securities legislation generally requires a fund's lending agent to be its custodian, and summary disclosure of securities lending activities typically includes a statement that the lending agent is the fund's custodian. Securities lending agreements should not be treated as material contracts when securities lending activities are immaterial to a fund's operations and to investors in the funds. Furthermore, the contents of a securities lending agreement are already mandated by NI 81-102. The terms that are not required by NI 81-102 are generally of a competitive and proprietary nature, including negotiated revenue sharing arrangements.

We believe that the above comments sufficiently address our concerns with the securities lending questions that the CSA has posed in the Proposals. Therefore we are not providing individual responses to these questions.

Fund-of-Fund Structures

As we interpret the explanation in the Notice to the Proposals, a non-redeemable NI 81-102 fund would be subject to the same fund of fund restrictions as would an NI 81-102 mutual fund (except in the stated case of a non-redeemable top fund that uses a forward agreement to obtain exposure to a non NI 81-102 underlying mutual fund that invests in accordance with the restrictions adopted by the top fund). There is no need to differentiate as to whether the top fund is an NI 81-102 mutual fund or an NI 81-102 non-redeemable fund. On this basis we believe the carve out for top funds that use forward agreements to gain exposure to non NI 81-102 mutual funds should apply equally to redeemable NI 81-102 top funds.

The text of the Notice makes clear that the CSA does not intend to permit a non-redeemable NI 81-102 to buy units in another non-redeemable NI 81-102 fund, as this would indirectly permit more leverage than the allowed limit. However, in what may be an error in drafting, we note that

the wording of proposed section 2.5 (2)(a) in the blacklined amendment to NI 81-102 (on page 91 of the release) appears to permit non-redeemable top funds to invest in any type of underlying fund other than an NI 81-104 fund. This wording suggests it is possible for the top fund in this case to have substantial exposure to leverage because it can invest in any fund other than an NI 81-104 fund. We seek the CSA's clarification of this issue.

B. Framework for Alternative Funds

At this stage we do not propose to comment on the proposed high-level framework for NI 81-104 alternative funds described in the Proposals, except to the extent that we perceive the proposed naming convention will impact open-ended NI 81-102 mutual funds.

Proposed Naming Convention

Our members are very concerned about the investor confusion that will result from implementing the proposed naming convention that would require NI 81-104 alternative funds to include words like "alternative fund" in their names and, potentially, require NI 81-102 conventional mutual fund names to include words like "conventional fund".

For such labeling to be at all informative to investors assumes that investors already know what a "conventional fund" and an "alternative fund" are so that they have some context about the differences in the attributes of such funds.

The plain language meanings of "conventional" include "of traditional design" and "ordinary, rather than different or original." The plain language meanings of "alternative" include "of or relating to activities that depart from or challenge traditional norms." The broad and vague meanings of these everyday words gives little guidance to investors as to the attributes of the fund they are considering purchasing. These terms may also be misleading. For example, use of the word "alternative" may create expectations that an alternative fund uses special strategies and that it will, therefore, perform better, or that the fund is riskier. On the other hand, "conventional" may suggest a somewhat safer and more modestly performing fund regardless of the investment objectives and strategies it employs.

We believe that the form and content currently required for disclosing risks and attributes of all funds meet the objective of ensuring that investors understand the features of the funds they may purchase. Rather than imposing a change in naming conventions, we would recommend bolstering the existing disclosure requirements to ensure disclosure clearly sets out the features of a given fund. What is essential for an investor to know is what the fund invests in and the strategy used to do so - subjects that cannot be described easily in a one word label. For example, the disclosure of a fund's strategies could state whether its strategies increase or decrease risk to the fund as compared to funds that do not use such strategies.

Strictly mandated language can be problematic. How would a mandated naming convention work for funds that have been granted exemptive relief from investment restrictions? The current practice is that disclosure of the permitted deviation is made within the disclosure documents. This is, in our opinion, the correct approach.

Finally, In order to assist our Members in understanding the CSA's view as to the exact meaning of these terms in the context of investment funds, there would be value to including clear definitions of what is meant by "alternative fund", "conventional fund" and any other fund types that today have only colloquial meanings.

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We thank you in advance for considering our Members' comments in response to the Proposals. Please feel free to contact me at (416) 309-2314 or at rhensel@ific.ca if you have any questions about our comments, or if you should require any more information.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

Ralf Hensel
General Counsel, Corporate Secretary and Director of Policy (Fund Manager Issues)