Annex D

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

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Part I – Background

Summary of Comments

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

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

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

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

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

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

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

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

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

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

3. We seek feedback on the initial restrictions and operational requirements we have identified for non-redeemable investment funds. If you disagree, what restrictions and operational requirements would be appropriate for non-redeemable investment funds and why? If you think no requirements are needed, please explain why.	Generally, all commenters agreed that the initial restrictions and operational requirements we identified for non-redeemable investment funds are core investor protections that should be codified. Some commenters, however, identified several issues regarding the current requirements that apply to conventional mutual funds and requested that we focus on rationalizing these provisions before we extend them to non-redeemable investment funds. ***Conflict of Interest Provisions*** One commenter noted the importance of extending the self-dealing requirements to non-redeemable investment funds because while there is a mechanism under NI 81-107 for the independent review of conflict of interest matters by a fund's independent review committee (IRC), NI 81-107 is not sufficient in ensuring that non-redeemable investment fund managers will appropriately deal with conflicts, since the onus rests with the manager to identify the conflict in the first place and present it to the IRC for its review. Two commenters expressed significant concerns regarding the complexity of the current conflicts of interest regime, which includes the securities regulations of many provinces, NI 81-102, NI 81-107 and NI 31-103. This has resulted in a compliance maze	We propose to apply many of the core requirements in NI 81-102 to non-redeemable investment funds in their current form. The CSA will not at this time make any substantial amendments to the Instrument that would affect mutual funds. We will consider whether specific provisions in NI 81-102 should be amended in the next stage of the Modernization Project. Pursuant to the proposed amendments, Part 4 will apply to non-redeemable investment funds to prohibit the same self-dealing transactions and investments in related entities in which mutual funds are currently prohibited from engaging. We currently do not propose any substantial amendments to the conflicts of interest requirements under NI 31-103 or NI 81-107. We will consider rationalizing the conflicts of interest regime in the context of future amendments to NI 81-107.

	where a single transaction often must consider multiple conflict of interest regulations (and on occasion, seek multiple discretionary exemptions) that ultimately address the same issue. These commenters urged us not to extend this complexity to non-redeemable investment funds, and encouraged us to instead rationalize the myriad of existing conflict of interest regulations for all investment funds. One commenter expressed support for extending the following restrictions to non-redeemable investment funds (subject to the provisions in NI 81-107): • purchases by funds of securities of related issuers (e.g., sections 111(2)(a) and 111(2)(c) of the *Securities Act* (Ontario)); • purchases by funds of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager (e.g., section 4.1(1) of NI 81-102). This same commenter suggested that it is not necessary to extend the following restrictions to non-redeemable investment funds: • fund-of-fund investing where a fund is held substantially by related funds (e.g., section	Under the proposed amendments, a non-redeemable investment fund will be subject to all the prohibitions in Part 4, including the purchase of securities of certain related issuers and the purchase of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager. We propose to apply the fund-of-fund requirements in section 2.5 to non-redeemable investment funds investing in mutual funds so that conflict of interest requirements that may apply in the context of a fund-of-fund investment would not

	111(2)(b) of the *Securities Act* (Ontario)), since principles of fund-of-fund investing adopted by NI 81-102 are already observed by non-redeemable investment funds in accordance with industry practice, and non-redeemable investment funds are by definition prohibited from investing for the purpose of exercising control of an issuer; • purchases of an issuer in which a responsible person of the fund is a partner, director, or officer (e.g., section 4.1(2) of NI 81-102), since this prohibition is already in NI 31-103; and • trades of securities with related persons as principal (e.g., section 4.2 of NI 81-102), since this prohibition is already in NI 31-103.	apply if the requirements of section 2.5 are complied with. Although certain prohibitions in Part 4 are also provided for in other instruments, the CSA are not considering the rationalization of the different conflicts of interest provisions at this time. As noted above, we will consider rationalizing the conflicts of interest regime in the context of future amendments to NI 81-107.
	Another commenter expressed concerns with the governance structure, transparency and accountability of the IRC model and the role played by the IRC in dealing with conflict of interest matters. This commenter recommended that we reconsider the IRC model across the spectrum of publicly offered investment funds.	The review of the IRC model under NI 81-107 is not within the scope of the Modernization Project.
	This same commenter, however, generally agreed that Part 4 of NI 81-102 was a useful model in regulating conflicts of interest. In	As noted in the response above, section 4.4 will apply to non-redeemable investment funds pursuant to the proposed

	particular, this commenter believes that the liability and indemnification provisions in section 4.4 of NI 81-102 should be included in any proposed rule, as it is a basic investor protection measure to prevent placing investors at risk for the negligence of service providers.	amendments.
	Securityholder and regulatory approval requirements Most commenters agreed that investors in non-redeemable investment funds should be entitled to vote on certain fundamental changes to the fund. Some further noted that current industry practice, as well as related corporate or listing requirements, already provide such entitlements.	Pursuant to the proposed amendments, Part 5 will apply to non-redeemable investment funds so that investors of non-redeemable investment funds will have the same statutory rights as mutual fund investors to vote on fundamental changes to the fund.
	One commenter would support the fundamental changes that require unitholder approval to include a change to the fund's fundamental investment objective only if fund managers of non-redeemable investment funds retain their current flexibility to articulate the fund's investment objective in a manner that the manager considers most suitable. In particular, this commenter does not think the requirement that conventional mutual funds disclose in their investment objectives the types of securities or key investment strategies the fund intends to invest in or utilize should be extended to non-redeemable investment funds.	We propose to apply the securityholder approval requirement in NI 81-102 for a change of investment objective by the non-redeemable investment fund. Form 41-101F2 currently requires a non-redeemable investment fund to disclose in its investment objective the type or types of securities the investment fund will primarily invest in, as well as any investment strategy that is an essential aspect of the investment fund. This requirement is similar to the requirement for mutual funds in Form 81-101F1. We do not propose to change these requirements,

		as we think all investment funds should articulate their investment objectives with the same degree of specificity.
	One commenter remarked that Part 5 of NI 81-102 is an ideal model to adopt for non-redeemable investment funds. This commenter believes that voting rights for fund investors are key elements of investor protection and provide a check and balance on fund governance for significant transactions of the fund. In particular, this commenter would support a provision that requires fund managers rather than investors to bear the costs associated with reorganizing funds.	We agree that Part 5 should be adopted for non-redeemable investment funds. We propose to apply substantially all the securityholder approval requirements to non-redeemable investment funds other than in limited circumstances. We also propose to add an additional requirement that prior securityholder approval be obtained where there is a change in the nature of the fund, i.e., from a non-redeemable investment fund to a mutual fund, from a mutual fund to a non-redeemable investment fund, or from an investment fund to an issuer that is not an investment fund. The merger pre-approval requirements applicable to mutual funds, including that mutual funds not bear the costs of the reorganization, are proposed to also apply to reorganizations of non-redeemable investment funds. We also propose to prohibit an investment fund from paying the costs of restructuring the fund. Given that reorganizations and restructurings permit managers to retain the fund's assets under management, these transactions are beneficial to managers and managers should accordingly bear the costs

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

	Another commenter, on the other hand, had concerns with the exemptions set out in NI 81-102 that permit significant reorganizations of funds without prior regulatory approval. This commenter believes that all fundamental transactions could benefit by being reviewed by the regulatory authorities.	See response above.
	Custodianship requirements Most commenters agreed that the segregation and security of investment fund assets is a paramount concern for investors and that these requirements should extend to all non-redeemable investment funds. It was also noted that it would make sense to move these requirements that are currently set out in a prospectus disclosure rule (NI 41-101) to an operational rule, as the requirements may have been overlooked by some industry participants who may expect NI 41-101 to relate mainly to prospectus content.	Pursuant to the proposed amendments, Part 6 of NI 81-102 will apply to non-redeemable investment funds. Part 14 of NI 41-101 will no longer apply to these funds.
	One commenter suggested that the current rule in NI 41-101 is too restrictive for non-redeemable investment funds because these funds often have investment mandates that require their assets to be deposited with a prime broker rather than a custodian. As well, the requirement that the custodian be a Canadian financial institution limits price competition between service providers. We were asked to	The CSA do not propose any substantive amendments to the custodianship requirements at this time.

	amend these requirements so that non-redeemable investment funds may deposit assets with prime brokers in accordance with industry practice and permit funds to access a broader universe of available custodians.	
4. Are there other investor protection principles and/or requirements of NI 81-102 which the CSA should consider for non-redeemable investment funds at this time? If so, please explain.	One commenter believed that rules and requirements beyond those identified by the CSA were not necessary, while a few commenters proposed additional investor protection principles that should be considered. ***Sales Communications*** Three commenters believed the regulation of sales communications to be a key value in promoting investor confidence and investor protection and recommended that we consider adopting an equivalent to Part 15 of NI 81-102 that applies to non-redeemable investment funds. These provisions would provide certainty as to what type of disclosure is permissible and would ensure that marketing materials prepared for non-redeemable investment funds contain relevant information and do not include misleading or unsubstantiated claims. One commenter	As noted above, the CSA believe there are key operational requirements in NI 81-102 in addition to the core protections identified in the notice that would provide a base level of protection for investors in non-redeemable investment funds. Imposing similar operational requirements would also level the playing field for all investment funds, providing a more consistent framework within which they can compete with each other. We propose to apply Part 15 to non-redeemable investment fund sales communications. The CSA are of the view that the sales communications requirements provide guidelines for investment funds to ensure that disclosure is relevant, consistent, and not misleading. The sales communication presentation requirements also ensure that disclosure of certain information such as performance data is standardized so that investors can make meaningful comparisons among similar investment funds.

	remarked, however, that these restrictions should not prevent non-redeemable investment funds from providing meaningful disclosure regarding new investment strategies or products which do not have a proven history or track record, provided that there is legitimate evidentiary support for such disclosure.	The requirements of Part 15 do not specifically prohibit disclosure regarding new investment strategies or products which do not have a proven history or track record. However, similar to mutual funds, we propose that sales communications for non-redeemable investment funds that present performance data present performance data based on actual historical performance, and not on hypothetical or back-tested data.
	Redemption of Securities of a Mutual Fund One commenter recommended that we adopt a requirement for non-redeemable investment funds to provide greater transparency to investors regarding the calculation of proceeds payable upon redemption of investment fund securities, particularly for investment funds that pay redemption proceeds that are less than the NAV per unit of the fund.	We propose to make a consequential amendment to Form 41-101F2 that requires a non-redeemable investment fund to disclose in its prospectus the amount, or the maximum amount or percentage that may be deducted from the net asset value per security, if the proceeds payable upon redemption of a fund's securities are based on the NAV per security. See proposed amendments to Form 41-101F2.
	This commenter also suggested that we adopt rules similar to Part 10 of NI 81-102 that require funds to have adequate procedures for processing redemption requests in a fair and timely manner and to suspend redemptions only when it is commercially reasonable to do	We also propose to apply certain provisions in Part 10 to ensure fair and timely administration of redemption requests and to limit when a non-redeemable investment fund may suspend redemptions. Similar to mutual funds, non-redeemable investment

	so. This commenter added that most non-redeemable investment funds already comply with these provisions since they reflect industry best practices.	funds will be required to mail a notice to securityholders annually, reminding investors of their redemption rights and how they may be exercised. See proposed amendments to Part 10.
	Another commenter urged us to address the gradual trend within the investment fund industry to make redemption options less and less attractive to investors of non-redeemable investment funds, especially because these investors already face thin markets for selling their units. This commenter suggested that where a redemption feature is part of a non-redeemable investment fund, we limit the allowable fraction of NAV at which non-redeemable investment funds may redeem units to no less than 95% of NAV.	We do not propose any requirements relating to the amount of redemption proceeds at this time. As mentioned above, we are requiring a non-redeemable investment fund to disclose in its prospectus the maximum amount of any costs or other fees that may be deducted from the net asset value per security when securities are redeemed, so that the amount received by an investor will be clarified.
	Disclosure requirements A few commenters expressed support for the adoption of point-of-sale delivery and disclosure requirements for non-redeemable investment funds.	The adoption of a point-of-sale disclosure regime for non-redeemable investment funds is not within the scope of the Modernization Project.
	One commenter recommended that non-redeemable investment funds be required to provide plain language disclosure as to how proceeds will be utilized.	Non-redeemable investment funds are required under Form 41-101F2 to disclose the principal purposes for which the net proceeds will be used by the investment fund and to disclose their fundamental investment objectives and the strategies

	Conversions One commenter requested that we consider adopting rules for the conversion of non-redeemable investment funds to open-end mutual funds.	used to invest the money received from the public. The Form also requires that disclosure in the prospectus be understandable to readers and presented in an easy-to-read format, as well as comply with plain language principles. Under the proposed amendments, a non-redeemable investment fund will have to obtain securityholder approval before increasing the frequency of redemptions and converting into a mutual fund. If the fund manager proposes to merge the non-redeemable investment fund with a mutual fund such that securityholders of the non-redeemable investment fund become securityholders of the mutual fund, prior approval of the securityholders of the non-redeemable investment fund must be obtained, unless the merger meets specified criteria in proposed subsection 5.3(2) of NI 81-102. A non-redeemable investment fund that has a built-in conversion feature that triggers regular redemptions based on NAV may be exempt from the securityholder approval requirement if it meets specified criteria, including prospectus disclosure of the event that will cause it to convert into a mutual fund. See proposed amendments to Part 5.

	Principles that should not be adopted for non-redeemable investment funds One commenter identified several provisions in NI 81-102 that would not be appropriate for non-redeemable investment funds due to their different investment strategies and distribution models: • seed capital requirements for establishing new mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of dealers pursuant to a "best efforts" agency agreement (Sections 3.1 and 3.2 of NI 81-102); • restrictions on incentive and performance fees paid to fund managers, since the ability to enter all sorts of fee arrangements may encourage innovation of non-redeemable investment funds, so long as clear disclosure is provided in their prospectuses and continuous disclosure documents (Part 7 of NI 81-102); • rules regarding the sale of fund securities as they relate to the sale of mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of Investment Industry Regulatory Organization of Canada (IIROC) dealers who are already subject to rules governing	The CSA agree that the specific requirements identified under Parts 3, 9, and 12 would not be applicable for non-redeemable investment funds. The CSA disagree, however, that the provisions under Parts 7, 11 and 14 should not apply to non-redeemable investment funds. The CSA are of the view that the provisions in Part 7 represent a fair basis for the payment of incentive fees. Since the CSA propose to apply comparable investment restrictions to non-redeemable investment funds that use conventional investment strategies, we are of the view that similar rules should apply to the payment of incentive fees by non-redeemable investment funds. As noted above, the CSA propose that investment funds that use alternative investment strategies be regulated under an amended NI 81-104, which allows for a wider range of incentive fee arrangements. While the CSA recognize that dealers of non-redeemable investment funds will be exempt from the requirements in Part 11 because they are members of IIROC, the CSA note that the provisions in Part 11 also

	the sales process (Part 9 of NI 81-102); • commingling of cash restrictions, since IIROC dealers generally distributing securities of non-redeemable investment funds are already subject to rules governing the commingling of cash (Part 11 of NI 81-102); • compliance reports other than in relation to compliance with redemption requirements, since Parts 9 and 11 are not applicable to non-redeemable investment funds (Part 12 of NI 81-102); and • record date requirements, since non-redeemable investment funds should have the flexibility to determine appropriate record dates for establishing the rights of securityholders to receive distributions, provided that the process for making these determinations is clearly disclosed in their prospectuses and continuous disclosure documents (Part 14 of NI 81-102).	apply to service providers of funds who receive cash on behalf of the investment fund for investment or redemption purposes. As the requirements in Part 11 ensure that investor cash is appropriately segregated, we are of the view that there is no policy rationale to support applying the requirements to service providers of mutual funds, but not to service providers of non-redeemable investment funds. See proposed amendments to Part 11. The CSA are of the view that the record date requirements in Part 14 should apply to non-redeemable investment funds on a similar basis as mutual funds, as there is no policy rationale to support different treatment. Currently, the record date requirements only apply to conventional mutual funds and not to exchange-traded mutual funds because exchanges impose rules on listed issuers in respect of setting record dates. Similarly, we propose to provide an exemption for non-redeemable investment funds that list their securities on an exchange. See proposed amendments to Part 14.
5. In addition to the initial requirements the CSA has identified for non-redeemable investment	Most commenters generally agreed that investment restrictions similar to Part 2 of NI 81-102 should not be adopted for non-	The CSA are of the view that a number of the investment restrictions in Part 2 are core investment restrictions that aim to promote

funds, we are considering the possibility of imposing certain investment restrictions, similar to those set out under Part 2 of NI 81-102. Please identify those core investment restrictions that, in your view, should apply to these funds and explain why. If you think no investment restrictions are needed, please explain why.	redeemable investment funds because the flexibility to implement alternative investment strategies in order to provide investors with exposure to different asset classes and innovative techniques is the primary distinction between conventional mutual funds and non-redeemable investment funds. These commenters feel that this distinction is beneficial to investors and should not be collapsed. Some commenters stressed that the liquidity and diversification requirements imposed on public mutual funds should not also apply to non-redeemable investment funds. This is because investors of non-redeemable investment funds generally have access to daily liquidity by trading their securities over a stock exchange and receive sufficient information regarding the NAV of the fund through various forms of disclosure. Further, requiring diversification to mitigate investment risks and volatility of the alternative investment strategies adopted by non-redeemable investment funds would be inconsistent with the purpose of investing in these funds. We were asked by one commenter to recognize the reliance placed by non-redeemable investment fund investors on the financial advisors and dealing representatives who sell	prudent management (for example, limiting counterparty risks under derivatives contracts) or define the fundamental characteristics of investment funds (for example, the control restrictions in section 2.2). We are also of the view that investment restrictions should apply in order to: (i) clarify the types of investments or investment strategies that the CSA do not view to be consistent with the passive investment nature of an investment fund; and (ii) more clearly delineate the types of investment strategies the fund is engaging in. However, we recognize that certain of the investment restrictions in Part 2 of NI 81-102 could be modified because of the differences in offering models, liquidity for securityholders, and distribution channels. For example, we seek comment on whether different issuer concentration limits and illiquid asset limits could apply for non-redeemable investment funds. See Annex A. We have observed that there is a wide spectrum of non-redeemable investment funds, ranging from non-redeemable

	these funds. These representatives are employed by full-service dealers that are members of the IIROC, and must satisfy higher proficiency requirements in order to understand the features of such funds and recommend them in suitable circumstances. A few commenters suggested that the additional investment risks and volatility associated with the investment strategies of non-redeemable investment funds could be addressed through disclosure. For example, one commenter suggested that any point-of-sale documents distributed by a non-redeemable investment fund disclose how the investment strategies of the fund differ from the investment restrictions set out in Part 2 of NI 81-102. One commenter urged us to consider investment restrictions for non-redeemable investment funds at the same time as any review of investment restrictions for open-end mutual funds. Specifically, any proposal to impose investment restrictions on non-redeemable investment funds should be deferred to Stage 2 of Phase 2 of the Modernization Project.	investment funds that invest in a similar manner as conventional mutual funds within the restrictions of NI 81-102 and non-redeemable investment funds that engage in more complex investment strategies. Non-redeemable investment funds may currently operate with a wide range of investment strategies with potentially very different levels of risk and complexity, but are all sold through the same distribution channel and subject to the same disclosure requirements. The CSA think it is important that investors can readily differentiate between investment funds that use conventional investment strategies set out in Part 2 of NI 81-102 and alternative funds that use investment strategies and invest in asset classes that are not permitted in NI 81-102. In order to continue to provide flexibility for non-redeemable investment funds to use alternative investment strategies, we are considering how to redesign NI 81-104 so that it will encompass both mutual funds and non-redeemable investment funds that wish to utilize alternative investment strategies. We agree that one way to address the additional investment risks and volatility

		associated with alternative investment strategies is through increased transparency. We are contemplating that a fund be permitted to have more flexibility in utilizing alternative investment strategies if it complies with the contemplated regulatory framework in NI 81-104, which would include enhanced disclosure requirements to help inform investors about the differences in investment restrictions and the potential for increased complexity and higher degrees of risk associated with investing in alternative funds. We also invite comment on the proficiency requirements for the sale of alternative fund securities. In the next stage of the Modernization Project, the CSA plan to review the investment restrictions in Part 2 for mutual funds.
	One commenter proposed that investment restrictions for non-redeemable investment funds be limited to the investment restrictions set out in sections 2.12 to 2.17 of Part 2 of NI 81-102. These requirements on securities lending, repurchase and reverse repurchase transactions, in particular requirements regarding documentation, supervision, controls and records, reflect industry best practices and	We propose to apply sections 2.12 to 2.17 to non-redeemable investment funds.

	would not be unduly restrictive on the transactions. Another commenter recommended that we impose an anti-tiering provision on non-redeemable investment funds. This commenter expressed concerns regarding the potential tiering of fees that could result from fund-of-fund arrangements, as well as the replacement of one fund manager's judgment with another, which does not provide any additional benefit to the investor. This commenter, however, would exclude money market funds, index participation units or other static, low-fee funds from such anti-tiering provision. Another commenter noted that while some investment restrictions should apply to non-redeemable investment funds including scholarship plans, the current investment restrictions that apply specifically to the subset of scholarship plans are far too restrictive and work to the detriment of plan holders.	The CSA propose that similar to mutual funds, non-redeemable investment funds investing in underlying mutual funds be prohibited from the duplication of fees in fund-of-fund structures. The proposed amendments for non-redeemable investment funds do not affect scholarship plans. Amendments for scholarship plans are outside the scope of the Modernization Project.
6. What do you foresee as the anticipated cost burdens in complying with the initial restrictions and operational requirements we are proposing for non-redeemable investment funds? Specifically, we request data from	One commenter noted that they would not be in a position to comment on the cost burden associated with the initial proposals until they have an opportunity to review the extent of changes under consideration. Several other commenters believed that the	The CSA have considered the anticipated costs and benefits of the proposed amendments to NI 81-102 to impose operational requirements on non-redeemable investment funds. We invite further comments on the costs associated with the proposed amendments. We think

the investment fund industry and service providers on the anticipated costs of complying with the Phase 2 proposals.	cost burden associated with the compliance of non-redeemable investment funds with the initial proposed restrictions and operational requirements would only be incremental and therefore not significant since these funds are already subject to the same requirements as conventional mutual funds under NI 81-106 and NI 81-107. One of these commenters also noted that any principal costs may be non-monetary, as additional regulations will hinder the ability of investors to access Canadian–based investment fund alternatives to conventional mutual funds.	that the proposed amendments, together with a reformed NI 81-104 framework, will continue to permit fund managers to create alternatives to conventional mutual funds.
Other suggestions for Phase 2	We also received several suggestions from commenters regarding other issues to address in Phase 2 of the Modernization Project. These recommendations include: • modernization of the regulation of mortgage funds, as National Policy No. 29 has not been re-considered by the CSA since the coming into force of NI 81-102; • reconsideration of National Policy No. 15 and the regulation of scholarship plans, and how this regulation would fit into the regulation of non-redeemable investment funds;	We thank all commenters for suggestions on additional issues to consider in Phase 2 of the Modernization Project. We have reconsidered the exemption to the rule preventing the reimbursement of organizational costs for exchange-traded mutual funds not in continuous distribution. The CSA propose to apply section 3.3 to all investment funds. We think imposing organizational costs on all fund managers could further align a manager's interest with those of investors and, at the same time, level the playing field for mutual fund and non-redeemable fund managers and discourage arbitrage opportunities. See

	• greater access by mutual funds to investments in physical commodities, especially through commodity-based exchange-traded funds and derivatives, to allow investors to benefit from preservation of capital, greater performance in inflationary environments, and improved portfolio diversification; • review of derivatives requirements, as several requirements that apply to specified derivatives require greater guidance (for example, terms such as "a high degree of negative correlation" found in the definition of "hedge" in NI 81-102 lead to inconsistent interpretations in the industry); • reconsideration of the definition of "illiquid asset" in NI 81-102, as the current definition may not necessarily address a mutual fund's need to fund redemptions on demand (e.g., one commenter believes that the current definition captures securities that are in fact liquid, and amendments should be made so that the definition contemplates not only the type of security held, but also the size of each security position in a fund and trading volumes in the market);	proposed amendments to Part 3. We may consider some of the other suggested changes in the next stage of the Modernization Project. At this time, we will continue to consider requests for exemptive relief from NI 81-102 on a case-by-case basis. Some of the issues identified, including the regulation of scholarship plans, promotion and sales of investment funds, and exempt markets, are outside the scope of the Modernization Project.

	• increased flexibility for fund-of-fund structures, particularly involving multi-layered structures, Canadian pooled funds, and non-Canadian investment funds, to increase diversification opportunities and improve cost efficiency for investment funds; • reforms in the promotion and sales of investment funds; • reconsideration of exemptions to the rules preventing the reimbursement of organizational costs for all non-redeemable investment funds, as there may be price discrimination issues between initial and subsequent investors; and • implementation of a "Clients First Model", a principle requiring industry participants to put the best interests of their clients first, which would require further tightening of rules related to conflicts of interest, advertising and marketing of investment funds, exempt markets and accredited investors, and the training of exempt market dealers.	
Other general comments	One commenter asked us to consider establishing an ongoing process for reviewing	Noted.

	NI 81-102, soliciting industry comments and amending NI 81-102 on a more frequent basis to ensure that the regulatory framework evolves and keeps pace with product innovations, evolving capital markets and the needs of investors. A few commenters noted that the Modernization Project should not be allowed to delay other important initiatives of the CSA, including the final stages of implementing the point-of-sale disclosure project.	Noted.

Part III – List of commenters

Commenters

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