



VIA E-MAIL:

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December 22, 2016

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

Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Me Anne-Maire Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22^e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

**Re: Re: Canadian Securities Administrators (CSA) Request for Comments
dated September 22, 2016 - Modernization of Investment Fund Product
Regulation – Alternative Funds**

We are pleased to provide comments on behalf of Mackenzie Financial Corporation (Mackenzie Investments) on the CSA's Request for Comments in regard to the proposed alternative funds regime.

Background – Mackenzie Investments

Mackenzie Investments is a portfolio manager and investment fund manager with total assets under management as at November 30, 2016 of approximately \$63.28 billion including mutual fund assets under management of approximately \$50.73 billion. Mackenzie Investments is a wholly owned subsidiary of IGM Financial Inc., which in turn

is a member of the Power Financial Corporation group of companies. We distribute our products to over 1 million clients across Canada through approximately 250 dealers representing over 30,000 financial advisors.

General Comments

Mackenzie Investments is aligned with the CSA in the desire to ensure continued access to high quality financial products for all Canadians. Mackenzie Investments is supportive of the CSA's ongoing initiative to modernize and broaden the array of products available within publicly offered investment funds. We believe the addition of alternative funds will effectively expand the investment strategies that are available for retail investors, while maintaining appropriate protections. In the current economic climate, it is essential to ensure that alternative strategies can be accessed for investors to enhance returns and reduce volatility.

We agree with most aspects of the proposed alternative fund rules which we believe at least in part are intended to give retail investors the opportunity to access investment strategies which are available to retail investors in other jurisdictions. These include event driven, equity market neutral, long/short credit, long/short equity, multi-alternative, absolute return and risk parity. We believe the name "alternative funds" and the related definition are appropriate and we are supportive of these products being sold under separate offering documents from conventional funds.

Our main concern with the proposed rules, discussed below, involves the total limitation on leverage, in particular, the component of the gross notional exposure test that measures specified derivatives exposure. While we support measuring derivatives leverage exposure on a gross notional amount basis, we believe certain derivatives trades need to be excluded from the test or measured differently to ensure the rules are sufficiently flexible to allow for the reasonable spectrum of alternative mandates the CSA envisioned under this framework. We have also provided feedback in regard to the risk classification assessment process, the proposed changes to National Instrument 81-102 related to short selling and the eventual proficiency requirements that will regulate the sale of alternative funds.

Total Leverage Limit

Mackenzie Investments agrees with the CSA's goal of imposing a limit on leverage. We understand the CSA's aim to create an objective, measureable standard to limit leverage within alternative funds. We believe the rules should establish a clear, concrete test that will allow investors to compare the maximum leverage to be employed by different alternative funds. However, we recommend several modifications to the derivatives aspect of the gross aggregate exposure calculation to ensure it is sufficiently flexible to permit alternative strategies while also achieving the goal of imposing a reasonable limit on leverage.

We assume the leverage limit is being imposed primarily to manage the overall risk associated with an investment in an alternative fund, in part to ensure that excessively speculative products are not made available to retail investors within this framework. We acknowledge that the currently proposed derivatives component of the leverage test has appeal in its objectivity and simplicity, however, we do not believe the current iteration of

the test provides an accurate or consistent indication of risk or expresses the fund's settlement obligations. Nor, as constructed, will it impose an appropriate limitation on leverage for many alternative fund mandates to operate within. We therefore recommend that the CSA consider the following modifications:

1. We recommend that specified derivatives trades made for "hedging" purposes as defined in National Instrument 81-102 be excluded entirely from the aggregate gross exposure calculation. We note that the current rules governing these trades by conventional funds suggest that derivatives trades made for "hedging" purposes do not contribute to leverage within a fund¹. If these trades are not excluded from the alternative funds gross notional exposure (leverage) test, then alternative funds and conventional mutual funds would be subjected to contradictory treatment for these trades within the same Instrument. We do not think it was intended to impose greater restrictions for the same category of trades, especially when the restrictions would be imposed on what is meant to be a more permissive regime.
2. The currently proposed exposure test has no regard for the type of trade, including whether the fund's obligations are tied to the notional amount (long vs short position). For example, we do not believe that an out of the money long call option should contribute to leverage based on its notional amount in the same manner that a written call option would. In the former scenario the fund's exposure is tied to the premiums paid whereas in the latter the fund could be required to deliver the entire notional amount upon settlement. The notional amount calculation should be adjusted to better reflect the fund's delivery obligations which, we submit, are a better reflection of actual leverage achieved.
3. The currently proposed test does not consider the nature of the underlying interest or asset class that is subject to the trade. Two trades with equal notional exposures and different underlying interests could potentially have drastically different risk parameters. We believe the CSA should consider building in a way to adjust the leverage/exposure for certain derivatives. This approach has been employed by CFTC as a means to calculate the amount of initial margin deposited by counterparties for certain uncleared swaps. We believe for certain standardized trades it may be appropriate to adjust the amount of notional exposure that contributes to the leverage test on a similar basis.
4. Finally, the proposed rule should permit an alternative fund to enter into an offsetting derivatives transaction which would have the impact of reducing its notional exposure. For example, if market movement results in a fund

¹ One of the stated goals of the current National Instrument 81-102 governing conventional funds is to prevent the use of specified derivatives to leverage the assets of the conventional fund (Section 4.3 of the Companion Policy). This is accomplished largely by distinguishing non-hedging and hedging derivatives trading, the latter of which are permitted to be traded without "cover" requirements.

temporarily exceeding the gross exposure threshold, the fund should have the ability to enter into an offsetting transaction to reduce its total leverage.

We believe these exceptions are critical to ensuring the limit is appropriately flexible for alternative mandates and that it is reflective of the leverage employed within these funds. In the event the CSA is not receptive to the above-mentioned exceptions, we believe it should consider increasing the maximum leverage ratio from three to four times the net asset value of the fund. Although this would not account for the issues described above, it would allow additional flexibility for portfolio managers to engage in these techniques without meeting their leverage limit quite as rapidly.

Short Selling

The proposed rules impose a combined limit on borrowing and short selling such that borrowed cash and assets sold short cannot exceed 50% of the net asset value of an alternative fund. This means that if an alternative fund were to engage in short selling but not borrowing, its total assets sold short could represent up to 50% of net asset value.

The proposed rules, however, do not include any revisions to subsection 6.8.1(1) of National Instrument 81-102, which does not permit conventional or alternative funds to deposit portfolio assets with any one borrowing agent (that is not a custodian) in excess of 10% of net asset value. This means, in practice, the restriction gives rise to the unintended outcome of requiring an alternative fund that borrows to short sell 50% of its assets to need relationships with five separate borrowing agents in order to comply with subsection 6.8.1(1).

We therefore recommend that the CSA increase the deposit limit within subsection 6.8.1(1) of National Instrument 81-102 for alternative funds that short sell, from 10% to 25% of net asset value to allow an alternative fund manager that seeks to short sell up to 50% of assets to use two borrowing agents, as opposed to five. Without this change, we submit that alternative funds will not take advantage of the new short selling requirement, as it will be operationally impractical to initiate five separate agreements and unduly burdensome to administer.

Proficiency

We agree with the CSA's approach to not embed registrant proficiency requirements into operational regulations. We note that the CSA is liaising with the Mutual Fund Dealers Association of Canada to determine whether additional guidance is necessary in regard to the sale of alternative funds to satisfy existing registration requirements under National Instrument 31-103 *Registration Requirements*.

In our view, alternative funds do not represent a significant departure from conventional mutual funds in terms of their complexity. Both are permitted to invest in certain physical commodities, both can conduct physical short sales and both can trade in specified derivatives. The differences relate primarily to the extent to which both vehicles are permitted to undertake these and other activities.

To the extent that the MFDA proposes additional proficiency requirements for alternative funds, we strongly recommend a principles based approach. In the U.S., the Financial

Industry Regulatory Authority (FINRA) has issued principles-based guidance on the sale of complex products, including funds that have novel or intricate derivatives features, hedge funds and securitized products.² We believe FINRA's flexible approach to proficiency is consistent with the general proficiency requirements set forth at Section 3.4(1) of National Instrument 31-103 which state that the (registered) individual must have the "education, training and experience that a reasonable person would consider necessary to perform the activity competently."

Risk Classification Methodology

We support standard deviation based measurement as an appropriate method to determine the risk profile of investment funds, including alternative funds. To ensure comparability, alternative fund risk category assessments should be determined using the same methodology as conventional mutual funds.

We do not, however, believe that alternative funds with less than ten years history should be required to use reference index performance as contemplated within the *CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts*, which is expected to come into force on March 8, 2017 ("Methodology"). Given the additional flexibility inherent within alternative fund mandates to employ leverage and invest in physical commodities, there will be mandates where an appropriate reference index may not be identifiable. Overall, we submit that the discretionary nature of many alternative fund mandates further contributes to the potential misleading nature of strictly using the standard deviation of a reference index to calculate alternative fund performance. Consider an alternative fund that employs an options writing strategy. The premiums received from options writing can enhance a fund's returns over time, however, in the event of certain unanticipated market events, these strategies can experience losses that are disconnected to most reference indices, including those selected using the reference index criteria within the Methodology.

We therefore submit that the reference index requirement within the Methodology be amended to afford greater flexibility to alternative fund managers. In circumstances where the most appropriate reference index is identified in accordance with the CSA principles does not, in the opinion of the manager, accurately reflect the returns, volatility and/or portfolio of the alternative fund, the manager should be permitted to adjust the alternative fund risk rating category on a discretionary basis. In the event this discretion is exercised, the manager should be required to include fund facts disclosure describing the adjustment from the risk category associated with the standard deviation of the reference index as well as a brief explanation on the reasons for the adjustment.

² FINRA's Regulatory Notice 12-03 on the sale of Complex Products includes requirements that registered representatives shall: "possess a sophisticated understanding of the payoff structure, any limit on upside potential and the risks to investors that the structure represents" (ii) "be competent to develop a payoff diagram of a structured product to facilitate his or her analysis of its embedded features..."; and (iii) "be trained to understand not only the manner in which a complex product is expected to perform in normal market conditions but the risks associated with the product."

Marketing Materials

With the introduction of a new category of investment funds, Mackenzie Investments supports responsible marketing practices. We note the CSA, and, individually, the OSC, have released guidance on investment fund marketing practices dating from 2007 to 2013.³ We believe this collective guidance provides useful support on a variety of marketing issues with regard to investment funds, including guidance on the use of hypothetical data. We suggest an expansion of this guidance to promote responsible use of sales communications for alternative funds. Below are examples of issues that have been addressed by FINRA in various publications and may be appropriate for inclusion within future OSC guidance:

- Ensure alternative funds are positioned within appropriate sub categories. Important to ensure funds are not sold under an umbrella category. Materials should fairly describe how the alternative product functions, consistent with its simplified prospectus.
- Ensure investors made aware how the alternative fund will respond to various market events or conditions.
- Ensure investors are made aware of which strategy the portfolio managers are likely to employ in certain market conditions.

We thank you for the opportunity to provide comments on the proposed rules governing alternative funds. We would welcome the opportunity to discuss our comments with CSA representatives. In particular, we would value the opportunity to meet to discuss our suggestions to improve the derivatives component of the gross aggregate exposure test in greater detail. Please feel free to contact the undersigned or Matt Grant at mgrant@mackenzieinvestments.com if you have any questions or require additional information.

Yours truly,

MACKENZIE FINANCIAL CORPORATION

“Michael Schnitman”

Michael Schnitman
Senior Vice President
Head of Product

³ OSC Staff Notice 33-729, OSC Staff Notice 81-720 and CSA Staff Notice 31-325, for example.