

MODERNIZATION OF INVESTMENT FUNDS UNDER NI 81-102
INVESTMENT FUND PRODUCT COMPARISONS

OVERVIEW OF THE MODERNIZATION PROJECT

The amendments to NI 81-102 consolidated the regulation of publicly offered mutual funds, closed-end funds, commodity pools and Exchange Traded Funds (ETFs) under one rule.

The differences between alternative mutual funds and privately offered investment funds (hedge funds) as well as the distinguishing features between alternative mutual funds, closed-end funds and conventional mutual funds are summarized in the tables below.

KEY DIFFERENCES BETWEEN ALTERNATIVE MUTUAL FUNDS AND PRIVATELY OFFERED HEDGE FUNDS – AT A GLANCE

Even though alternative mutual funds provide investment flexibility when compared to conventional mutual funds, they are relatively limited compared to the diverse investment strategies that may be utilized by privately offered investment funds (hedge funds). In addition, the Canadian securities regulatory regime imposes obligations on alternative mutual funds that are significantly different from those applicable to hedge funds.

The key restrictions and reporting obligations applicable to alternative mutual funds relative to hedge funds are set out in the following table:

| | ALTERNATIVE MUTUAL FUNDS | HEDGE FUNDS |
|--|--|---|
| Eligible Investors | Available to the retail investors. | May only be distributed on a “private placement” basis in reliance on a prospectus exemption and are typically sold to high net worth investors that qualify as “accredited investors”. |
| Key Documents/Ongoing Disclosure Requirements | Publicly filed simplified prospectus, annual information form, fund facts document, audited annual and interim financial statements and management reports of fund performance. Mandated leverage disclosure in annual and interim financial reports. Top 25 portfolio holdings disclosed quarterly. | Investors typically receive an offering memorandum and audited annual and interim financial statements (which are not publicly filed). No mandated leverage disclosure or disclosure of top portfolio holdings. |
| Governance | Independent Review Committee requirement. | No specific governance requirements. |
| NAV Calculation | Alternative Mutual Funds: Daily. | Hedge Funds: Daily, Weekly, Monthly (most common) or Quarterly depending on frequency of subscriptions and redemptions. |
| Redemption Rights | Daily (most common) or weekly as specified in Prospectus. | Weekly, monthly (most common) or quarterly. Monthly redemptions typically require a minimum of 30 days advance notice prior to the applicable redemption date. |
| Initial Holding Period | None, although managers may utilize Short Term Trading Fees as a disincentive and new alternative mutual funds have the ability to have an initial freeze on redemptions for the first 6 months from date that the fund is first offered, all as specified in the prospectus. | May be none, 4 months, six months, a year or longer. |

| | ALTERNATIVE MUTUAL FUNDS | HEDGE FUNDS |
|---|--|---|
| Redemption Proceeds | T+2. | T+2. |
| Risk/Compliance Management | Daily monitoring of portfolio vs permitted limits in NI 81-102 and any other investment restrictions described in the prospectus. | Regular monitoring of portfolio vs investment restrictions of fund and restrictions generally imposed under applicable securities laws. |
| Performance/Incentive Fees | Permitted, subject to the requirement that a performance fee may only be paid based on performance which has occurred since the time that a performance fee was last paid. | Permitted (no limitations). |
| Borrowing (cash and / or securities) | Limited to 50% of NAV. | No limit. |
| Short-Selling | Limited to 50% of NAV, no cash cover required. | No limit. |
| Leverage | Maximum of 3X (excludes hedging via specified derivatives). | No limit. |
| Concentration Limit – issuer level | 20% of NAV, subject to carve-outs (does not apply to short sale of government securities). | No limit. |
| Illiquid Assets | 10% of NAV at initial investment; 15% hard-cap. | No limit. |
| Restrictions on Investment | No investment in: Real Property; Mortgages, other than guaranteed mortgages; or Loan syndications / participations if any responsibility to administering loan. | No limit. |
| Risk ratings | As per NI 81-102, all Funds must have a risk rating as per the CSA's methodology. | No risk rating requirement. |
| Fund of Fund investments | May invest up to 100% of NAV in underlying alternative mutual funds, non-redeemable investment funds, conventional mutual funds and ETFs funds. Underlying funds must be NI 81-102 Funds and a reporting issuer in at least one Canadian jurisdiction. Investing in private pooled funds prohibited. | No limit. |

COMPARISON OF ALTERNATIVE MUTUAL FUNDS, CLOSED-END FUNDS AND CONVENTIONAL MUTUAL FUNDS

| Category | Alternative Mutual Funds | Closed-end Funds | Conventional Mutual Funds |
|---|--|--|---|
| Definition: | <p>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 under NI 81-102.</p> <p>Investment funds that were formerly referred to as “commodity pools” and were governed by NI 81-104 are now designated as alternative mutual funds and are governed by NI 81-102.</p> | N/A | N/A |
| Concentration Limit: | 20% of NAV | 20% of NAV | 10% of NAV |
| Investments in Physical Commodities: | May invest in precious metal certificates, permitted precious metals, physical commodities or specified derivatives of which the underlying interests are physical commodities | May invest in precious metal certificates, permitted precious metals, physical commodities or specified derivatives of which the underlying interests are physical commodities | May invest up to 10% of NAV in permitted precious metals, permitted precious metal certificates or specified derivatives of which the underlying interests are physical commodities |
| Illiquid Assets: | 10% of NAV with hard cap of 15% of NAV | 20% of NAV with hard cap of 25% of NAV | 10% of NAV with hard cap of 15% of NAV |
| Short Selling Limit: | 50% of NAV | 50% of NAV | 20% of NAV |
| Single Issuer Short Sale Limit: | market value of 10% of NAV excluding shorting of “government securities” | market value of 10% of NAV excluding shorting of “government securities” | market value 5% of NAV |
| Limit on portfolio assets pledged as security with a borrowing agent (other than the custodian or a sub-custodian) in connection with Short Sale Transactions: | 25% of NAV | 25% of NAV | 10% of NAV |
| Cash Borrowing Limit: | Up to 50% of NAV | Up to 50% of NAV | Not permitted for investment purposes |
| Combined Shorting and Cash Borrowing Limit: | 50% of NAV | 50% of NAV | N/A |
| Use of Specified Derivatives: | May be used for investment purposes (including hedging) and/or to create synthetic leverage | May be used for investment purposes (including hedging) and/or to create synthetic leverage | <p>primarily for hedging purposes.</p> <p>Limited to 10% of NAV for purposes other than hedging</p> |

| Category | Alternative Mutual Funds | Closed-end Funds | Conventional Mutual Funds |
|--|---|---|---|
| Derivative Counterparty Rating and Exposure Limits: | Can deal in specified derivatives (OTC) or with counterparties that do not have a designated rating. | Can deal in specified derivatives (OTC) or with counterparties that do not have a designated rating. | Must deal in specified derivatives and/or counterparties that have a designated rating. |
| | Mark to market value of exposure under specified derivatives positions (other than cleared specified derivatives) with a counterparty that does not have a designated rating must not exceed 10% of NAV for a period of 30 days or more | Mark to market value of exposure under specified derivatives positions (other than cleared specified derivatives) with a counterparty that does not have a designated rating must not exceed 10% of NAV for a period of 30 days or more | Mark to market value of exposure under specified derivatives positions with any one counterparty must not exceed 10% of NAV for a period of 30 days or more unless: (i) the specified derivative is a cleared specified derivative, or (ii) the counterparty/guarantor of counterparty's obligations has a designated rating. |
| Fund of Fund Investments: | May invest up to 100% of NAV in conventional mutual funds, other alternative funds or non-redeemable investment funds that are subject to NI 81-102 | May invest up to 100% of NAV in conventional mutual funds, other non-redeemable investment funds or alternative mutual funds that are subject to NI 81-102 | May invest up to 10% of NAV in alternative mutual funds or non-redeemable investment funds that are subject to NI 81-102 |
| | | | May invest up to 100% of NAV in another conventional mutual fund that is subject to NI 81-102 |
| Leverage and Leverage Calculation Formula: | 300%, calculated as aggregate value of indebtedness under borrowing agreements + aggregate market value of short positions + aggregate notional value of all specified derivative positions minus specified derivatives used for hedging purposes | 300%, calculated as aggregate value of indebtedness under borrowing agreements + aggregate market value of short positions + aggregate notional value of all specified derivative positions minus specified derivatives used for hedging purposes | N/A |
| Incentive Fees: | Permitted provided that the basis of calculation must be described in simplified prospectus and incentive fee must be subject to a permanent "high water mark" | Permitted provided that the basis of calculation must be described in prospectus and incentive fee must be subject to a permanent "high water mark" | Permitted provided that the basis of calculation must be described in simplified prospectus and incentive fee must be calculated in reference to a total return benchmark or index |
| Redemption of Securities: | If disclosed in simplified prospectus, permitted to suspend redemptions for first 6 months after date of final simplified prospectus. | Redemption price must not be more than the NAV determined on a redemption date specified in the prospectus or annual information form. | Redemption price must be NAV next determined after receipt of the redemption order. |
| | Otherwise, may redeem at NAV determined on the first or second business day after date of receipt of redemption order and pay redemption proceeds within 15 business days | Redemption proceeds must be paid no later than 15 business days after the valuation date on which the redemption price was determined. | Redemption proceeds must be paid within two business days after the determination of the redemption price. |

| Category | Alternative Mutual Funds | Closed-end Funds | Conventional Mutual Funds |
|--|---|---|---|
| Custodial Arrangements: | Removes requirement for affiliates of domestic and foreign banks and trust companies to have “publicly available” financial statements showing minimum level of equity. | Removes requirement for affiliates of domestic and foreign banks and trust companies to have “publicly available” financial statements showing minimum level of equity. | Removes requirement for affiliates of domestic and foreign banks and trust companies to have “publicly available” financial statements showing minimum level of equity. |
| Seed Capital: | \$150,000 that may be redeemed once \$500,000 from outside investors is received | \$150,000 that may be redeemed once \$500,000 from outside investors is received | \$150,000 that may be redeemed once \$500,000 from outside investors is received |
| Ability to Charge Organizational Costs and Preparation of Initial Offering Documents to the Fund: | No | Permitted for exchange-traded mutual funds that are not in continuous distribution. | No |
| Offering Documents: | Simplified Prospectus, Annual Information Form and Fund Facts | Long Form Prospectus, Annual Information Form and Fund Facts/ETF Facts | Simplified Prospectus, Annual Information Form and Fund Facts |

Source: McMillan LLP