

Update on Alternative Funds (Liquid Alts)

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On September 22, 2016, the Canadian Securities Administrators (CSA) published *Notice and Request for Comment – Modernization of Investment Fund Product Regulation – Alternative Funds* (the Proposals). The Proposals involve a series of amendments to National Instrument 81-102 *Investment Funds* (NI 81-102) and represent the final phase of the CSA's ongoing policy work to modernize investment fund product regulation.

The Proposals introduce a regulatory framework that allows publicly offered mutual funds to invest in asset classes or use investment strategies not otherwise permitted under NI 81-102. The framework establishes a new category of prospectus offered investment funds called "alternative funds". These funds are commonly referred to as "liquid alts".

The net effect of the Proposals is that alternative funds not listed on a stock exchange would be subject to the same disclosure regime as conventional mutual funds under National Instrument 81-101 *Mutual Fund*

Prospectus Disclosure, which includes the preparation of a simplified prospectus, annual information form and fund facts document, with the fund facts having to be delivered at or before the point of sale.

The 90-day comment period closed on December 22, 2016 and the CSA received 41 comment letters. Overall, the industry reaction to the Proposals has been positive and many commenters expressed their support for the CSA's initiative to make liquid alts available to retail investors in Canada under NI 81-102. Some of the points

raised in several comment letters include, among others, excluding the notional value of derivatives used for hedging purposes from the calculation of the 300% leverage limit which will be applicable to alternative funds, permitting the offering of alternative funds that follow market neutral strategies and exempting government securities from the short sale limits.

As of now, the CSA has yet to confirm the exact date the amendments would come into force. However, the Proposals are expected to be in place by the middle of 2018. ■



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How to Prepare for Liquid Alts

A Checklist for Alternative Investment Fund Managers



Consider which strategies can be conducted under the proposed investment restrictions for alternative funds. Could you offer new strategies as alternative funds?



Consider whether existing private funds could be prospectus qualified under the new rules or whether newly created funds would be preferable.



Review your business plan filed in connection with your existing securities registrations to ensure it covers offering alternative funds to the public.



Review your existing material contracts to determine if they require amendment for alternative funds.



Consider whether you need to develop relationships with additional service providers (e.g. administrators, transfer agents).



Examine existing custody and prime brokerage arrangements to determine if changes are necessary for new alternative funds (currently the custodian requirements in NI 81-102 do not allow most prime brokers to custody assets).



Consider distribution channels for alternative funds and open dialogue to get alternative funds approved by dealers.



Review sales and marketing practices to ensure they comply with National Instrument 81-105 *Mutual Fund Sales Practices*.



Consider any potential conflict of interest which may arise for the manager with alternative funds.



Prepare for establishing an independent review committee as required for all public investment funds to review conflicts of interest with the manager.



Review internal policies and procedures and compliance manual; make any amendments or adopt additional policies and procedures as may be required to offer retail funds.



Consider how the new risk classification rules will apply to alternative funds to ensure that any proposed alternative funds will be able to calculate and disclose risk.

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