FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

August 23, 2013

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RE: Request For Comment On Modernization of Investment Fund Product Regulation (Phase 2)

FAIR Canada is pleased to offer comments on the proposed core operational requirements for publicly offered non-redeemable investment funds including the creation of an alternative fund framework, and related amendments for mutual funds. In particular, FAIR Canada will provide comments relating to the Canadian Securities Administrators' ("**CSA**") first stage in Phase 2 of the implementation of the modernization of investment fund product regulation project ("**Modernization Project**") contained in CSA Staff Notice published as (2013) 36 OSCB (Supp-3) ("**Notice**") on March 27, 2013, as narrowed by CSA Staff Notice 11-324 dated June 25, 2013 which extended the deadline for comment and specified certain proposed amendments in which feedback is sought (the " Notice 11-324").

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada Executive Summary:

1. FAIR Canada continues to support the CSA's Modernization Project and we support the attempt to establish core operational requirements for non-redeemable investment funds analogous to those applicable to mutual funds in NI 81-102. We provide comments on some of the specific proposed changes to non-redeemable investment funds at section 2 below.

2. While CSA Notice 11-324 indicates that the framework for alternative funds will be given more detailed consideration at a later date, FAIR Canada nonetheless provides some initial comments about the creation of a new category of investment funds called "alternative funds". FAIR Canada is of the view that the creation of a category of investment funds which are "alternative funds" and which allow alternative investment strategies which present, in general, much greater complexity and higher risk, should, at a minimum, only be permitted if clear labelling is required, in the name of the fund itself (and the category) which makes the complexity and higher risk of this category of funds abundantly clear to retail investors.

3. FAIR Canada supports improving proficiency requirements for all registrants who sell investment funds, and, in particular, increase proficiency requirements for registrants selling alternative funds.

4. While improved disclosure and oversight of the sales process (to ensure suitability) have been the focus of regulators in the past, many leading jurisdictions are moving beyond this approach and are intervening at an earlier stage to ensure that new products serve the needs of the customers to whom they are marketed.

5. FAIR Canada recommends that the CSA consider similar reforms (such as risk labelling of products or banning certain product features sold to retail investors) in order to adequately protect investors. While disclosure is a necessary aspect of securities regulation, it alone will not provide adequate protection to retail investors. The provision of long, detailed lists of material facts in lengthy, complex and legalistic documents will not serve to protect retail investors in the absence of further fundamental reforms.

6. FAIR Canada believes that better labelling in the name of the investment fund of the heightened risk and complexity along with more robust regulation and enforcement of misleading advertising, coupled with a best interest standard, would go a long way to helping to protect investors.

7. FAIR Canada urges the CSA to move ahead with point-of-sale summary disclosure for other products including ETFs, structured products, and other complex and high risk products which would fall in the “alternative investment funds”/”magnified risk” category.

8. FAIR Canada believes that in the context of the proposed modernization of investment fund regulation, it would be appropriate to reconsider the Independent Review Committee (“IRC”) model as we do not see it as an appropriate vehicle for managing conflicts of interest of fund managers.

9. FAIR Canada is of the view that the vast majority of Canadians who own investment funds are unaware that the securities held by their funds are being loaned out, let alone what amount of revenue is going to the investment fund versus the lending agent (whether affiliated or not) or portfolio manager. The investors are exposed to the risks without their knowledge and the extent of those risks are not transparently disclosed to the investors. Securities lending rules must be reformed in the interests of fairness. FAIR Canada provides suggestions to improve transparency and better align the interests of the fund manager with the fund at section 3 below.

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1. FAIR Canada Supports the Introduction of Core Operational Requirements for Non-Redeemable Investment Funds

1.1. FAIR Canada continues to support the CSA's Modernization Project and we support the attempt to establish core operational requirements for non-redeemable investment funds analogous to those applicable to mutual funds in NI 81-102. We support the CSA’s objective of identifying and addressing market efficiency, investor protection and fairness issues that arise out of the differing regulatory regimes that apply to different types of publicly offered investment funds.

Non-Redeemable Investment Funds Significant to Canadians' Investment Portfolios

1.2 FAIR Canada notes that as of the end of 2011, the mutual fund industry managed 73.8% of all Canadian investment fund industry assets under management, with the remaining 26.2% of Canadian investment fund industry assets under management being made up of the following investment fund assets: hedge funds (1.7%), closed-end funds (or non-redeemable investment funds) (3.1%), segregated funds (3.5%), exchange-traded funds (4.2%), pooled funds (4.6%) and insurance company pools (9.1%).[1] As explained in the Notice, "[n]on-redeemable investment funds are commonly referred to as "closed-end funds" because they issue a fixed number of securities rather than an unlimited number of securities on a continuous basis and can only be redeemed on an infrequent basis.

Closed-End Funds Owned by Small Retail Investors

1.3 FAIR Canada notes that closed-end funds appear to have higher operating expenses than mutual funds (see FINRA Investor Alert discussed in paragraph 1.10 below) and higher commissions to dealers/advisors than mutual funds and tend to be illiquid, long-term investments[2]. In addition, they tend to be held predominantly by small retail investors[3]. Assuming this is also the case in Canada, the regulatory scheme should aim to improve transparency, effective competition and investor protection.

FAIR Canada Supports CSA's Approach of a Single Trunk of Operational Rules

1.4 FAIR Canada supports the CSA's overall approach of having a single trunk of basic operational rules which will apply to both non-redeemable investment funds and mutual funds, analogous to those applicable to mutual funds in NI 81-102 so as to provide a baseline of protections. FAIR Canada provides specific comments on some of the proposals below at section 2.

Clear Labelling of Alternative Funds Required – Risk-Magnified Funds

1.5 While CSA Notice 11-324 indicates that the framework for alternative funds will be given more detailed consideration at a later date, FAIR Canada nonetheless provides some initial comments about the creation of a new category of investment funds called "alternative funds". FAIR Canada is of the view that the creation of a category of investment funds which are "alternative funds" and which allow alternative investment strategies which present, in general, much greater complexity and higher risk, should, at a minimum, only be permitted if clear labelling is required, in the name of the fund itself (and the category) which makes the complexity and higher risk of this category of funds abundantly clear to retail investors. The category "alternative" does not make sufficiently clear to the average retail investor the level of risk and complexity that is associated with these funds. The word "alternative" does not denote anything of particular importance to the average retail investor and simply begs the question, "alternative to what"?

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1 CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees, at page 11234.

2 Deli, ND "Mutual Fund Advisory Contracts: an empirical investigation J. Finance 57:109 at 33, refered to in Cherkes 2012).

3 Martin Cherkes, Jacob Sagi and Richard Stanton, ssrn paper, "A Liquidity-Based Theory of Closed-End Funds, August 25, 2006 at pages 9-10, available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=799804&download=yes.

1.6 FAIR Canada supports improving proficiency requirements for all registrants who sell investment funds, and, in particular, increase proficiency requirements for registrants selling alternative funds.

Other Jurisdictions Moving Beyond Disclosure

1.7 While improved disclosure and oversight of the sales process (to ensure suitability) have been the focus of regulators in the past, many leading jurisdictions are moving beyond this approach and are intervening at an earlier stage to ensure that new products serve the needs of the customers to whom they are marketed. Such regulatory intervention includes:

- Implementation of a best interest standard and a prohibition on embedded commissions;
- Product transparency, such as risk labelling (for example, Denmark has implemented a traffic light labelling system with three categories ("green" investment products – risk of losing the entire amount is very small and product is fairly easy to understand; "yellow" investment products – risk of losing the entire or partial amount yet product itself not complex nor difficult to understand; or "red" investment products – risk of losing more than the amount invested or the product is difficult to understand or complex);
- UK regulators are considering banning certain products or product features for segments of retail investors;
- UK regulators are considering additional training and competence requirements or prohibiting non-advised sales; and
- Belgium has a voluntary prohibition on distribution to retail investors of structured products that are complex (Belgium).

1.8 FAIR Canada recommends that the CSA consider similar reforms in order to adequately protect investors. While disclosure is a necessary aspect of securities regulation, it alone will not provide adequate protection to retail investors. The provision of long, detailed lists of material facts in lengthy, complex and legalistic documents will not serve to protect retail investors in the absence of further fundamental reforms.

1.9 The current proposals could be augmented, for example, by improving product transparency through risk labelling. FAIR Canada notes that under the current proposals, the fundamental difference between closed-end funds and mutual funds, on the one hand, and the proposed "alternative funds" on the other hand, is that alternative funds are permitted to use strategies that magnify risk as they are permitted to have:

- Higher concentration limits;
- Wider permission to invest in physical commodity investments;
- Fund-of-fund structures;
- Larger borrowing ratios;
- Short selling;
- Use of specified derivatives; and
- Higher leverage limits.

FAIR Canada suggests that such funds be called "Risk-Magnified Funds", "Higher-Risk Funds"or some other term that sets out clearly that such funds carry increased risks, as compared to closed-end funds and mutual funds. Of more importance than the nomenclature of the fund category ("alternative funds", versus "conventional funds" for example) is the naming and labelling of the individual investment funds that will be marketed, advertised and sold to retail investors.

FINRA Investor Alert on Alternative Mutual funds

1.10 The Financial Industry Regulatory Authority ("**FINRA**") has recently issued an investor alert on alternative mutual funds warning of their non-traditional investments (such as global real estate, commodities, leveraged loans, start-ups and unlisted securities) and their use of complex trading strategies and cautions investors to fully understand a fund's investment structure, strategy risks factors, investment objectives, high operating expenses, the fund manager's track record and background, and short performance history for many of these funds which have only existed post-2008.[4]

1.11 **FAIR Canada issued two reports in 2009 on leveraged, inverse and commodity ETFs which called on regulators to protect retail investors from these potentially harmful financial products that were not suitable as buy and hold investments, whether in an RRSP or other investment portfolio.** In June 2009, IIROC issued a guidance note for its dealer members on their duties with respect to these complex products and some retail firms chose to prohibit their advisors from selling these products to retail investors. FINRA, in the United States, also issued a Regulatory Notice on leveraged and inverse exchange-traded funds. Despite the success in drawing attention to the potential hazards in these products, there continue to be disciplinary cases and cases before the Ombudsman for Banking Services and Investments ("**OBSI**") where these ETFs have been sold to retail investors for whom they were not suitable.

1.12 **FAIR Canada believes that better labelling in the name of the investment fund of the heightened risk and complexity along with more robust regulation and enforcement of misleading advertising, coupled with a best interest standard, would go a long way to helping to protect investors.**

Deliver Point of Sale Disclosure Before Fund Sold For All Investment Funds

1.13 **FAIR Canada urges the CSA to move ahead with point-of-sale summary disclosure for other products including ETFs, structured products, and other complex and high risk products which would fall in the "alternative investment funds"/"magnified risk" category**. We are of the view that such point of sale disclosure should be adopted as soon as possible and certainly before allowing any relaxation from current restrictions that may be applicable.

1.14 FAIR Canada disagrees with the CSA's statement in its comments on Phase 2 proposals for the Modernization Project that the adoption of a point-of-sale disclosure regime for non-redeemable investment funds is not within the scope of the Modernization Project.[5] FAIR Canada believes that such summary disclosure is extremely important in ensuring adequate investor protection and

[4] Alternative Funds Are Not Your Typical Mutual Funds, FINRA Investor Alert, available online at http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/MutualFunds/P278033.

[5] The Notice, at page 39.

could highlight the factors contained in the recent FINRA investor alert on Alternative Funds. We do not understand why the CSA would take this position.

2. FAIR Canada's Comments on Proposed Changes Applicable to Non-Redeemable Investment Funds

Organizational Costs

2.1 **FAIR Canada supports the proposal to introduce new requirements for the managers to bear the organizational costs of launching a new fund. At present, the organizational costs are paid out of the proceedings of the initial public offering of the non-redeemable fund and are borne by investors, while managers of mutual funds pay the organizational costs of establishing new mutual funds and recoup such costs through ongoing management fees. FAIR Canada does not see why investors should pay for the organizational costs when they pay ongoing management fees for closed end funds and believes that this proposal will also prevent managers launching non-redeemable investment funds that convert to mutual funds within a short period of time thereafter, thereby launching a mutual fund while avoiding the payment of organizational costs.**

2.2 FAIR Canada notes that the benefits of such a change include: (i) aligning the interests of managers with those of investors to have a sustainable investment fund in the long term (ii) increase managers' efficiency when launching funds and (iii) level the playing field between managers of mutual funds and non-redeemable investment fund managers, and discourage the arbitrage opportunities described in the preceding paragraph.

Fund-of-Fund Structures

2.3. In its submission dated September 24, 2010 to the CSA[6], FAIR Canada recommended that a study be undertaken of the fees charged in tiered investment fund structures in order to determine whether tiered funds (or fund of fund products) provide any substantial benefits to investors, in terms of either performance or risk, and to determine the extent of the detriment to investors in terms of increased fees. FAIR Canada recommends that this research be carried out, if not already publicly available.

2.4. FAIR Canada agrees that non-redeemable investment funds should not be permitted to invest in other non-redeemable investment funds and, until such time as the above-noted research is conducted and made publically available, sees no compelling reason to allow a non-redeemable investment fund to invest in a mutual fund.

Conflicts of interest Provisions

2.5. **FAIR Canada believes that in the context of the proposed modernization of investment fund regulation, it would be appropriate to reconsider the Independent Review Committee ("IRC") model as we do not see it as an appropriate vehicle for managing conflicts of interest of fund managers.** FAIR Canada provided comments on the weaknesses of this model of fund governance

[6] Submission of FAIR Canada dated September 24, 2010 at paragraph 3.4, available online at http://faircanada.ca/wp-content/uploads/2008/12/Mutual-funds-RFC-100924-Final-Sign.pdf..

in its submission dated July 25, 2011[7] and also commented on its inherent weakness in our submission on the mutual fund fee structure in response to the CSA Consultation Paper 81-407 Mutual Fund Fees[8].

2.6. FAIR Canada believes that the conflict of interest provisions, including the self-dealing provisions of Part 4 of NI 81-102 are a useful model, with the exception of the exemptions provided by approval of the IRC. This is an opportune time to revisit the IRC model.

2.7. We do not agree with the CSA Response in Part II that "The review of the IRC model under NI 81-107 is not within the scope of the Modernization Project."

Securityholder and Regulatory Approval Requirements for Fundamental Changes to Non-Redeemable Investment Funds and their Management (Part 5 of NI 81-102)

2.8. FAIR Canada supports the codification of securityholder approval requirements for major, fundamental transactions similar to those in Part 5 of NI 81-102. Voting rights for fund investors is a key element not only of investor protection but also as a check and balance on fund governance in significant transactions, as noted in our July 25, 2011 submission.

2.9. We also support the redrafting of the requirement to obtain regulatory approval for a change in control of the manager and its inclusion in subsection 5.5(1)(a.1) of NI 81-102 rather than subsection 5.5(2).

2.10. **FAIR Canada supports the requirement that prior securityholder approval be obtained to implement a change to the nature of an investment fund, and in particular, prior securityholder approval be required to implement any change that would convert a mutual fund into a non-redeemable investment fund, convert a non-redeemable investment fund into a mutual fund or convert an investment fund into an issuer that is not an investment fund. Given that such changes would be fundamental, two-thirds securityholder approval should be required.**

2.11. FAIR Canada agrees that the costs and expenses to implement any such changes should not be borne by the investment fund (including costs of obtaining securityholder approval and, if applicable, the costs of filing a simplified prospectus to commence a continuous distribution). We agree with the CSA that "[g]iven 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."[9] This is also consistent with Part 5 of NI 81-102 which requires that none of the investment funds participating in any merger, acquisition or amalgamation event shall bear any of the costs associated with such a transaction.

2.12. Exemptions from securityholder approval for those non-redeemable investment funds that are structured from inception to convert to a mutual fund on the occurrence of a specified event should be required to have plain language disclosure to this effect prominently disclosed in the

[7] In response to CSA Phase 2 Proposals for the modernization of investment fund product regulation project contained in CSA Staff Notice 81-322, in particular at paragraph 4.2 to 4.7.

[8] Submission of FAIR Canada dated April 12, 2013 at paragraph 5.17, available online at http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-Mutual-Fund-Fees.pdf.

[9] CSA Consultation Paper, Appendix D: Part II at page 36 (2013) 36 OSCB (supp-3).

prospectus and any sales communication materials along with prior notice of the conversion to securityholders. FAIR Canada believes that the importance of the disclosure of such information to investors supports our recommendation that the CSA implement point-of-sale disclosure for non-redeemable investment funds as soon as possible.

2.13. FAIR Canada does not agree that exemptions to regulatory approval should be allowed for specialized non-redeemable investment funds that have a limited life and that do not list or trade on a secondary market. While such approvals will be routine, such transactions would be improved and assisted by the provision of review by regulatory authorities. Again, an exception from securityholder approval requirements should be premised on plain language disclosure of the exemption which is prominently disclosed in prospectus and sales communication materials.

Custodianship Requirements

2.14. FAIR Canada agrees with the harmonization of Part 6 of NI 81-102 to the requirements of Part 14 of NI 41-101 and the application of the custodianship requirements to all investment funds including non-redeemable investment funds.

2.15. The segregation and security of investment fund assets is a key concern of investors and such requirements should apply to all investment funds including non-redeemable investment funds.

Warrant Offerings

2.16. FAIR Canada supports Part 9.1 of NI 81-102 which prohibits an investment fund from issuing warrants, rights or other specified derivatives the underlying interest of which is a security of the investment fund. Warrants tend to dilute the value of the securities that are held by investors who do not exercise the warrants and/or force the investor to put more money into the fund and are coercive. **Investors are faced with the choice of making an additional investment (which they may not have wished to do and may not be in their best interest) or face the risk of dilution.**

2.17. We agree with the CSA that investors do not expect the costs of warrant issuances to be part of their investment bargain and should be prohibited as anti-investor.

Sales Communications Parameters (Part 15 of NI 81-102);

2.18. FAIR Canada agrees that if a mutual fund was converted from a non-redeemable investment fund and it wishes to present performance data it must present past performance data for the period when it existed as a non-redeemable investment fund. FAIR Canada's comments on marketing and advertising, are found in section 1 above.

Incentive Fees

2.19. FAIR Canada recommends that the CSA review the parameters for incentive fees and assess their appropriateness in light of the introduction of a best interest standard.

3. FAIR Canada's Comments on Annex C: Securities Lending, Repurchases and Reverse Repurchases

3.1. FAIR Canada is of the view that the vast majority of Canadians who own investment funds are unaware that the securities held by their funds are being loaned out, let alone what amount of revenue is going to the investment fund versus the lending agent (whether affiliated or not) or portfolio manager. The investors are exposed to the risks without their knowledge and the extent of those risks are not transparently disclosed to the investors. There should be a significant financial benefit to the fund from securities lending otherwise it should not be permitted. Securities lending rules must be reformed in the interests of fairness.

3.2. The European Securities Market Authorities ("**ESMA**") issued new guidelines in July 2012 to strengthen investor protection in this area[10].

3.3. The CSA Consultation Paper states: "While we think that the current operational requirements are generally comparable to existing standards in other international jurisdictions, as a result of this review, we are considering additional rules to enhance the transparency of the returns, costs and risks of securities lending, repurchases and reverse repurchases by investment funds, particularly where conflicts of interest may arise in connection with these activities."

3.4. FAIR Canada is of the view that greater transparency is an important first step in this area. This transparency is important for regulators as well as investors, as securities lending can create liquidity and counter-party risk, and can lead to systemic risk. Understanding the extent of securities lending among Canadian investment funds, the degree of profitability and how the revenues and costs are distributed is a necessary first step.

3.5. As stated in the Consultation Paper: "As the investment fund bears all the risks from securities lending, repurchases and reverse repurchases, the CSA are of the view that the revenue from engaging in these activities, after the payment of costs for conducting the activities, should be received only by the investment fund." This is similar to the recent ESMA Guidelines where fund managers must now return all revenue, net of costs, generated via securities lending back to fund shareholders. Fund providers, under the EMSA rules also have to disclose, in a fund's prospectus, any direct or indirect fees and costs from securities lending, and the identity of the parties to which such fees and expenses are paid. [11]

3.6. FAIR Canada supports reform which will result in better aligning the interests of the fund manager with the fund. The current situation, where fund managers take a portion of the lending fees (which is not transparent or disclosed) while the unit holders are responsible for the losses, risks and reward is not a fair system nor does it mitigate potential systemic risks. FAIR Canada sees the present practice as a breach of the fund manager's fiduciary duties to the fund, and it should not be permitted on this principled basis, but appears to have been allowed nonetheless.[12]

3.7. However, as pointed out by commentators, the adoption of the ESMA Guildeines will not necessarily result in funds paying more money to investors as a result of securities lending

[10] European Securities and Markets Authority, Guidelines on ETFs and other UCITS issues, July 25, 2012

[11] Alastair Kellett, July 27, 2012 "ETF Rules Do Not Ensure More Money For Investors, available online at www.morningstar.co.uk/uk/news/69948/PrintArticle.aspx

[12] "Securities Lending Sees Landmark Ruling in FAvour of Investors, in Canadian Business, Larry McDonald, 2012.

revenue. The reason is the ability for "creative accounting" – when the return to the fund is net of direct and indirect fees and expenses and providers can allocate those fees and expenses as they see fit, including to related (affiliated) securities lending agents, then the rule loses its intended effect. What is a cost and what is revenue are at the discretion of the manager; therefore, a requirement that all net revenues from securities lending shall be returned to the fund requires careful scrutiny of what costs are deducted. Otherwise, there will not be any benefit to investors, the net revenue will be $0 and the profit to the manager (or the affiliated lending agent who splits revenue with the fund) will be booked as a cost of lending, to the detriment of the fund's investors.

3.8. As noted by Kellett, costs can be incurred at various stages of the securities lending process and can include such items as:

- Rebates to securities borrowers in order to facilitate relationships;
- Lending agent fees
- Custodial fees;
- Fees drawn from investments made with cash collateral; and
- Fees taken by the fund provider to arrange the service.
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There should be a significant financial benefit to the fund from securities lending otherwise ti should not be permitted.

3.9. A key question is who is in the best position to scrutinize how the securities lending program of a fund is structured and accounted for. FAIR Canada does not see retail investors as having the ability to fulfill this function. If the fund governance was reformed so as to have an independent board of directors rather than the inadequate IRC model, then the board of directors would be in a position to put the portfolio managers to task and ask the hard questions.

3.10. There should be clear disclosure of the potential risks that the investment fund's securities lending program creates, as well as disclosure of any profitability and its costs. We agree that there should be enhanced transparency of the benefits from securities lending and the costs paid to earn the returns. Moreover, there should be transparency as to the risks that the securities lending creates for the investment fund.

3.11. In FAIR Canada's view, disclosure of any conflict of interest with an affiliated or otherwise non-arms-length lending agent, must be clear and must also address how the conflict is being appropriately managed so as not to disadvantage the investment fund (and, therefore, its investors). Mere disclosure of the fact of the conflict is insufficient (although is better than the present situation where there is a complete lack of transparency).

3.12. Please find below specific questions and answers asked in the Notice and FAIR Canada's response:

Question2: "What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the revenue from securities lending inclusive of the share paid to the agent? What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the costs of securities lending?

The CSA could ensure that the revenue is declared inclusive of the share paid to the agent by requiring that funds only be permitted to lend under agency agreements that specify that agents will return full and complete disclosure of lending revenue received by the agent and any associated party, with a detailed breakdown of associated costs deducted from that gross revenue. This will need to include the fair pro rata share of any lock-up agreement that a lending agent may have pursuant to which it receives revenue in respect of securities loaned or repurchased. Requiring this is not a step that will be cumbersome or unwieldy. In terms of costs, fund managers must be required to include not only costs that are expenses paid to third parties such as lending agents from the gross lending revenue, but also any cost of its own expended for securities lending purposes.

Question 8: Would disclosure of the indemnities obtained by an investment fund from its lending agent in the AIF or prospectus of the investment fund be useful for investors in assessing the risks from securities lending?

It has been pointed out[13] that extensive securities lending by ETFs begin to make these superficially simple products into complex products, due to their complex lending operations, highly diverse conditions under which the lending takes place and the significant liquidity and counterparty risk. Given that securities lending by ETFs appears to be heterogeneous[14], at a minimum, disclosure of the indemnities would be a necessary step. Additionally, the CSA should consider whether a certain amount of indemnification is required.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-214-3443 (ermanno.pascutto@faircanada.ca) or Marian Passmore at 416-214-3441 (marian.passmore@faircanada.ca).

Sincerely,

Canadian Foundation for Advancement of Investor Rights

[13] Rodrigo Amaral, "Regulators voice fears over danger to retail investors" fundweb October 10, 2011, available online at http://www.fundweb.co.uk/fund-strategy/issues/10th-october-2011/regulators-voice-fears-over-danger-to-retail-investors/1039172.article.

[14] Rodrigo Amaral, supra, see chart of ETF providers and securities lending.