INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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And

- British Columbia Securities Commission
- Alberta Securities Commission
- Financial and Consumer Affairs Authority of Saskatchewan
- Manitoba Securities Commission
- New Brunswick Securities Commission
- Registrar of Securities, Prince Edward Island
- Nova Scotia Securities Commission
- Superintendent of Securities, Newfoundland and Labrador
- Superintendent of Securities, Northwest Territories
- Superintendent of Securities, Yukon
- Superintendent of Securities, Nunavut

Dear Sirs and Madams:

Re: Proposed Investment Fund Product Regulation Modernization Amendments

The Investment Industry Association of Canada (IIAC), on behalf of our member investment dealers, is pleased to respond to the Canadian Securities Administrators' (CSA's) Notice and Request for Comment, released on March 27, 2013 and titled *Proposed Amendments to National Instrument 81-102 Mutual Funds, Companion Policy 81-102CP Mutual Funds and Related Consequential Amendments and Other Matters Concerning National Instrument 81-104 Commodity Pools and Securities Lending, Repurchases and Reverse Repurchases by Investment Funds* (the Proposed Amendments) and to the additional elaboration of CSA Staff Notice 11-324, dated June 25, 2013. We appreciated the opportunity to meet with CSA Staff on July 15, 2013 to discuss a number of issues, and look forward to working with CSA Staff and closed-end (non-redeemable) fund market participants to achieve regulation that meets both investor protection and capital market efficiency goals. The following pages provide a high-level summary of our recommendations and attached are our detailed comments.

1. **Implement:** We support efforts to modernize regulation, for example, by bringing the subject of many exemptive relief orders into the rules for efficiency and greater transparency. Also, we agree with a good number of specific provisions in the Proposed Amendments embodying what the CSA had described as "core investor protection and fairness principles" in 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* (Staff Notice 81-322), as well as other items in the Proposed Amendments. The provisions we support fully or conceptually (in which case, some minor and, we believe, non-contentious proposed technical clarifications can be found in the attachment) are the following, in the order in which the items appear in the Proposed Amendments:

   i. Part 4: Conflict of interest provisions;

   ii. Part 5: Securityholder and regulatory approval amendments for fundamental changes;

   iii. Part 5: Proposed new securityholder approval requirements;

   iii. Part 6: Custodianship requirements;

   iv. Part 10: Redemption requirements

   v. Part 11: Prohibitions on the commingling of cash;

   vi. Part 14: Record dates set as in NI 81-102, except that non-redeemable investment fund listings on an exchange would follow the applicable exchange rules regarding record dates;

   vii. Part 15: Sales communication requirements for the presentation of past performance data for a mutual fund converted from a non-redeemable investment fund; and

   viii. Part 18: Non-redeemable investment funds requirements to maintain and make available securityholder records.

   We are not commenting at this time on certain points, such as warrant offerings, where we defer to the issuers that we believe are more appropriate parties to comment, or seed capital and subscription requirements, where the CSA's stated intention is to maintain current regulatory differences between conventional mutual and closed-end funds.

2. **Clarify grandfathering for consultation and review period:** The Proposed Amendments state that: "Other aspects [of the Proposed National Instrument (NI) 81-102 Amendments], particularly certain proposed investment restrictions that are interrelated with NI 81-104, will require more time to consider and evaluate. We expect these components to be considered in conjunction with any

related amendments to NI 81-104 and to come into force contemporaneously at a later date." For this review period, in the interest of current closed-end fund investors, who may risk price impacts from the uncertainty introduced (for reasons not attributed clearly in the Proposed Amendments to market failure) by unexpected changes to the regulation of these funds, we strongly urge the CSA to confirm that it intends to grandfather substantive investment provisions related to existing closed-end funds, and further issuances for these funds, as soon as possible.

In particular, closed-end fund issuers and underwriters (investment dealers/agents) should know as soon as possible whether they can develop and offer new funds in substantially the same manner as they can now. Practically speaking, grandfathered provisions would be those relating to concentration, illiquid asset, leverage, borrowing and securities lending restrictions in order to avoid affecting the availability, cost and return profiles of investors' closed-end funds (existing ones and those that we hope will be issued during the review-and-comment period for both NI 81-102 and NI 81-104 with any follow-on issuances). The prospect that new funds may be required to be changed significantly is having a chilling effect on the industry already: June, which is typically one of the busiest issuance months of the year, saw only two offerings.

3. **Consult further before changing:** In light of the fact that:
   i. the Modernization Project's goals are very ambitious;
   ii. CSA Staff Notice 81-322 (while mentioning the *possibility* of additional operational requirements) referred to point-of-sale disclosure for publicly offered investment funds beyond open-end mutual funds and whether it would be beneficial for investors if certain investment restrictions in NI 81-102 were *loosened*; and
   iii. a number of new concepts have been raised for the first time in the Proposed Amendments,

   we believe that additional time can and should be devoted to discussion and analysis of aspects of the Proposed Amendments.

   During this period, investor protection concerns will be satisfied not only by existing 'Know Your Product' (KYP) and 'Know Your Client' (KYC) rules, but also by the client relationship model (CRM) requirements under NI 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. This recently updated rule provides for enhanced suitability requirements, which we believe would work to protect investors even absent KYP provisions. The foregoing also are complemented by (i) an increase in the already extensive Investment Industry Regulatory Organization of Canada (IIROC) monitoring and supervision activities, as well as (ii) the existing investor access without cost to recourse options where the suitability of an investment is inappropriate for an investor. Specifically, we recommend the following:

   i. The Proposed Amendments regarding investment and other restrictions described in point 2. above, as well as organizational costs, should be implemented only to the extent that research has revealed problems or losses that the proposed amendments would have solved. We otherwise see the potential for negative effects on capital market efficiency that are not offset by measurable investor protection advances that we have been able to identify. As an example, applying limits at proposed levels simply because most or all existing funds do not exceed them ignores and will eliminate the flexibility that may be needed in certain market conditions. Furthermore, we believe that if the access of clients to investments they currently use comfortably and the availability of competitively priced investment alternatives are inhibited, the effects would be contrary to investor interests. For example, changing the way organizational costs are paid may result in new ways of charging these costs that investors find unappealing (a recent fund offering, where organizational costs were not recovered as currently, evidenced higher management fees, new back-end fees and a service fee in contrast to other typical recent offerings).

ii. As the Proposed Amendments pertaining to the Alternative Funds Framework represent a significant new departure and warrant additional dialogue, further analysis and discussion should take place before we believe stakeholders can reasonably provide useful comments.

In summary, we agree that the core investor protections described in point 1 above should proceed this year, and ask that the requested announcement in point 2 be given high priority. Also, we believe that further discussion of points 3.i and 3.ii should be undertaken before decisions on the content and implementation timeline of such provisions are made. This is because we believe that closed-end funds, with a current aggregate market capitalization of approximately $30 billion, while perhaps a proportionately small portion of Canadian capital markets in market capitalization, are an important option for investors.

- **From an investor perspective**, closed-end funds are typically structured to provide regular cash distributions. With interest rates at historic lows and an aging population, closed-end funds provide both the higher yield-earning opportunity and steady cash flow that retirees want, and can provide the customization needed to address changing market conditions (e.g., strategies designed to protect portfolios from the effect of rising interest rates) that is not possible under the conventional mutual fund regime.

- **From a capital-raising (and therefore job-creation) perspective**, Canadian junior mining and oil and gas issuers rely on closed-end funds to raise capital that permits the flow-through of tax benefits to the investor, adding to a client's net return. In future, it is possible that biotech and high-tech companies will similarly depend on this financing option.

- **For Canadian capital markets generally,** closed-end funds form a major part of Canadian initial public offerings (IPOs). Closed-end funds represented 32% of the 93 IPOs on the Toronto Stock Exchange in 2012, and 49% of the $4.3 billion raised in 2012 (In the two preceding years, closed-end funds averaged 30% of IPOs and 42% of IPO value). Clearly, these funds are important for the vibrancy of the exchanges and Canada's capital markets' reputation.

We look forward to discussing the foregoing and attached recommendations with you and other stakeholders. We have noted and appreciate the CSA's extension in the time to respond, but are providing our comments now so that we may use the intervening time to provide any clarifications you would like of our comments. We also will be providing comments to the provincial ministries responsible for finance and economic growth to the extent that there may be some direct or indirect impact on capital-raising, and we may have additional input based on other developments this summer.

Yours sincerely,

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DETAILED COMMENTS ON
PROPOSED INVESTMENT FUND PRODUCT REGULATION MODERNIZATION AMENDMENTS

In order to ensure honest and responsible conduct by market participants, provincial securities legislation typically requires securities regulators to: (i) establish requirements for timely, accurate and efficient disclosure of information; (ii) set restrictions on fraudulent and unfair market practices and procedures; and (iii) maintain high standards of fitness and business conduct. Regulatory authorities are also mandated to ensure that regulatory costs, including restrictions on market participant business and investment activities, are proportionate to the significance of the regulatory objectives sought to be realized. We believe that there is more disclosure for closed-end (non-redeemable) funds than mutual funds; we are not aware of unfair or illegal market practices or procedures; and we think that there is strong evidence that Investment Industry Regulatory Organization of Canada (IIROC) regulated firms and IIROC-registered advisors meet high standards of compliance and proficiency that leave Canadian investors well-protected.

For easy reference, our comments below are organized as follows:

BACKGROUND – CLOSED-END FUNDS COMPARED TO CONVENTIONAL MUTUAL FUNDS

Conventional mutual funds are among the key ways that investors first enter the capital markets. Such funds offer diversification, liquidity, the ability to buy in small quantities and the benefits of a professional manager to those people who may not have the time, expertise or interest to invest on their own, or who lack the assets to warrant use of an investment dealer that can offer the full range of investment services these investors may want or need. As investors at this stage are often less financially experienced, the CSA applies investor protection requirements aimed at reducing risk by placing general restrictions on these funds. While this can limit returns and add costs, frequently the benefits alone from good advice as to which investments to put in registered versus open accounts can cover the costs of investment.

As a client's assets grow and as clients approach and enter retirement, they will often need to look beyond one-size-fits-all investments for ones that are more tailored to their specific portfolio requirements: while a pool of assets, closed-end funds can be looked at by some as more closely akin to an individual investment that can round out a portfolio of stocks, bonds and other securities. Also, these and many other investors continue to seek yield – sources of interest and dividends. While one other product – income trusts – in the past was effective at providing investors with yield, these investments were effectively made uneconomic by tax changes some years ago, leaving closed-end funds as one of the best ways to fill this need.

While both conventional mutual and closed-end funds provide professional management and economies of scale from the pooling of assets, and both may pay out consistent cash flows (appealing when cash yields on bonds are low), there are a range of notable differences between these two types of funds, such as the following:

- **Alternate approaches to coming to market:** Conventional mutual funds are issued on a continuous basis by a single investment fund manager using a simplified prospectus and annual information form (sometimes for multiple funds). In contrast, closed-end funds use a registered investment dealer (typically a syndicate of dealers), and are marketed over a limited period, typically not longer than six weeks. As well, closed-end funds have detailed long-form prospectuses describing the various strategies that will be employed by the fund, such as, among other things, leverage, hedging, covered call writing, payment of distributions, and the tax treatment of distributions associated usually with a single fund. The use of registered investment dealers leads to extensive scrutiny of each closed-end fund by the agents with external legal counsel, risk assessment experts and other professionals of multiple entities, rather than by a conventional mutual fund's single fund manager and advisors.

- **Liquidity achieved through different means:** While conventional mutual funds are issuable and redeemable daily at their net asset value (NAV), closed-end funds do not give holders the right to redeem units on a daily basis and are not in continuous distribution. From a manager's perspective, a higher level of liquid assets is required, therefore, to meet daily conventional mutual fund NAV redemption demands than is required for a closed-end fund to meet its (typically) annual NAV redemption commitment (while a small number of closed-end funds have redemptions more frequently than annually, in practice such redemptions occur in very limited circumstances).

  Closed-end fund market practices evolved to provide annual redemptions at 100% of NAV after an initial period, typically 18 months, although redemptions are not required under the law for closed-end funds. While the annual redemption mechanism at NAV is an important tool for reducing the trading discount relative to NAV that certain closed-end funds may experience, from an investor's perspective, liquidity for closed-end funds is most frequently available through a trade on an exchange. Importantly, liquidity by way of the stock exchange allows investors to sell or buy closed-end funds with greater price certainty at or near particular times in the day as compared to conventional mutual fund investors who buy or redeem funds at end-of-day NAV.

- **Investments vary:** Conventional mutual funds offer a more standardized investment offering, governed by a broad set of rules under NI 81-102, that is intended to be suitable for all investors, while closed-end funds are designed to offer asset classes, industry sectors and features that may otherwise not be available in a conventional mutual fund. For example, some closed-end funds employ leverage to provide enhanced exposure to investment grade corporate bonds, while eliminating the interest rate risk associated with such bonds (typically the most volatile component of an investment grade bond) by selling short an equivalent amount of Treasury bills or Government of Canada debt.

- **Flexibility of mandates differs:** Many closed-end fund investors want access to closed-end funds that have greater certainty of monthly or quarterly cash distributions, use techniques to reduce volatility and protect the value of their assets. For instance, some closed-end funds may employ strategies designed to reduce volatility or lower certain risks, such as interest rate risk, credit risk or other market risks.

- **Marketing and distribution approaches differ:** Conventional mutual funds are sold on an ongoing basis through mutual fund and IIROC dealers and their advisors. Closed-end funds, in most cases, are marketed once only at the time of their initial public offering and distributed generally through full-service investment dealers.

- **Compensation models are dissimilar:** There is a commission to buy and sell closed-end fund units, but the funds do not typically have deferred sales charges or the higher service fees associated with many conventional mutual funds. Also, the expense ratio of closed-end funds is typically less than that of conventional mutual funds, allowing greater annual compounding of earnings. Market practice is annual service fees of generally no greater than 50 basis points (bps).

- **Minimum fund size can vary:** By industry practice, the investment dealers require that at least $20 million be raised for there to be a closed-end fund closing, ensuring greater certainty than for conventional mutual funds of achieving a fund of sufficient size. This ensures minimum levels of liquidity and spreads the fixed ongoing costs of administering the fund over a larger base.

- **Organizational costs are different:** With respect to launch costs, reimbursing managers for offering or organizational expenses is prohibited for conventional mutual funds, but not closed-end funds where all of the securities of the fund are sold with a single closing. The appropriateness of this model was most recently recognized in 2012 amendments to NI 81-102 regarding ETF launch expenses.

  The significant majority of offering or operational costs relate to securities legislation. While it has been suggested that marketing costs should not be charged to funds, our members advise that while aspects of issuance costs are subject to discussion, the focus has not been on marketing costs, which are typically 10% or less of total organizational costs (these "road show" costs include the expense of travel and meetings to facilitate broader knowledge of the particular closed-end fund's features and a broader purchaser base, which are both in investors' interests). Rather, concerns with organizational expenditures are raised with respect to the more substantial aspects of the costs that relate to use of a long-form prospectus, requiring not only greater registered investment dealer involvement, but also multiple legal counsel and an auditor (about two-thirds of expenses), with additional costs for translation, printing, etc.

  Moreover, assuming there might commonly be launch costs of around $600,000 for a closed-end fund offering, a significant component of this is at risk of loss if the closed-end fund offering does not generate the minimum $20 million. As well, in all cases, market practice has led to offering expenses in excess of 1.5% of gross proceeds of a closed-end offering being borne by the manager. In contrast, there would be considerably less at risk in the case of conventional mutual funds. Specifically, with a $20 million minimum fund size, this cap is $300,000, enabling smaller funds to come to market. A closed-end fund 10 times the size – one of $200 million – would still see costs of around $600,000 to $750,000, as most of the costs are relatively fixed: unlike in the case of conventional mutual funds, these costs are not charged out as part of the management expense ratio in perpetuity.

- **Price discovery opportunities vary:** For clients watching their investments daily, the ability to monitor market prices of closed-end funds easily during the day may be more attractive than accepting the end-of-day NAV because such clients may prefer to have more control of the timing of their investment's purchase or sale. Also, price on an exchange may provide clients with more information than NAV alone: many investors may not know to check whether the conventional mutual fund is in a net redemption situation that may indicate they will pay a future increased share of management expenses.

While apparently perceived as riskier than conventional mutual funds by the CSA, the top 35 closed-end funds by market capitalization (excluding commodity funds) have experienced an average five-year total return of 20.2% during a highly volatile period, compared to a 17.6% return on conventional (excluding money market) mutual funds. The 35 closed-end funds represent nearly a third of total closed-fund value and 33% or more by volume, value and trades in the first quarter of 2013 (refer Appendix).

CLOSED-END FUND REGULATION

Closed-end funds are regulated directly and through standard market practices (for example, those referenced above and provision for unitholder approvals similar to those required by law for conventional mutual funds). Where the CSA has expressed concern in the past with respect to closed-end funds, we believe that it has generally been limited to a few specific areas, such as converting to conventional mutual funds (OSC Staff Notice 81-711, *Closed-End Investment Fund Conversions to Open-End Mutual Funds*).

Conventional mutual fund and closed-end fund investors both also have withdrawal and rescission rights, as well as rights of action for rescission or damages for a misrepresentation in a prospectus.

In contrast to conventional mutual funds and as noted above, closed-end funds have a long-form prospectus and other features more comparable with corporate issuances (indeed, closed-end funds are identified under Public Companies (rather than Investment Fund Groups) on the System for Electronic Document Analysis and Retrieval (SEDAR), the filing system the CSA developed to facilitate the electronic filing and communication with regulators of securities information and its dissemination to the public). Long-form prospectuses must include extensive general business and financial information about the company; detailed terms regarding the securities offered and the intended use of proceeds; and risk factors related to the purchase of the securities.

The process leading up to and following obtaining regulatory approval for closed-end funds is similarly more elaborate than for conventional mutual funds:

- **Prior to syndication**, the lead agent engages in extensive vetting of proposals, including: reviewing historical data, volatility, worst-case drawdown, comparisons with benchmark indices, correlations, etc.; tax., structural and other risks; manager assets under management, tenure and experience in managing the proposed strategy; etc.

- **In the syndication phase**, the lead agent must convince other dealers invited to join the syndicate of dealers on the merits of the offering. Those invited to participate in the agents' group or syndicate are given the opportunity through a formal due diligence meeting to scrutinize leverage, derivatives usage, short-selling and other features particular to different closed-end funds before agreeing to participate. In addition, the prospectus is prepared with the assistance of external securities counsel (typically separate counsel for both the issuer and the dealers) and subject to rigorous due diligence by the dealers and their counsel.

- **Once in distribution**, closed-end funds are subject to further scrutiny by investment dealers. IIROC-regulated dealers offering closed-end funds, and the dealers and advisors engaged in making these closed-end funds available to clients are subject to multi-level regulatory requirements, complemented by market practices. In fact, the Joint Forum Product Disclosure and Regulation Committee, in its April 2, 2013 report "Financial Product Development Standards and Practices", wrote:

> "The work and processes of dealers and advisors who distribute [investment] funds ensure the advisors know their products, that they know their clients, and that they will recommend funds that are suitable to the objectives, circumstances and risk tolerance of each client. This process occurs separately from the manufacturer but is an integral, and highly regulated, part of ensuring the investor is provided with the appropriate product."[1]

Specifically, investment dealers and their advisors are subject to three integral and inter-related requirements that work to protect investors even in the absence of product regulation *per se*:

- ***Know your product (KYP) requirements and reviews:*** IIROC firms must consider the attributes and risks of the products they are recommending to advisors making investments available to their clients. Reviews, in the case of closed-end funds, must consider the product features and structure (including leverage, derivatives use, complexity, conflicts of interest); risks; costs; management; the issuer's history and financial strength; reasonableness of expected returns; and types of clients for whom the product may be appropriate. Additional reviews must be undertaken if there is a material change in the aforementioned factors.

- ***Know your client (KYC) requirements and reviews:*** In addition to understanding the products that they sell, IIROC advisors must determine whether the products meet their clients' general investment needs and objectives, and consider any other factors necessary for them to be able to determine whether a proposed purchase or sale is suitable.

- ***Enhanced suitability:*** Beyond taking into account KYC and KYP requirements, IIROC dealers and advisors must engage in additional suitability requirements, namely taking into account the investor's time horizon and current investment portfolio composition with risk level. As well, specific events will trigger automatic suitability reviews.

Of relevance, we believe that these current regulatory provisions measure up well against regulatory standards put forward by the International Organization of Securities Commissions (IOSCO) and referred to in IOSCO's *Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation* (September 2011) (the IOSCO Assessment Methodology):

> "Regulation of securities and derivatives markets is necessary for the achievement of the three IOSCO core objectives [to cooperate on consistent standards of regulation; enhance investor

[1] The Joint Forum's, "Financial Product Development Standards and Practices" at pp. 29-30, April 2, 2013 (http://www.jointforum.ca/en/init/product_dislcosure/fin_product_dev_stds.pdf).

protection and confidence in the integrity of securities markets; and exchange information]. Nevertheless, inappropriate regulation can impose an unjustified burden on markets and inhibit market growth and development.

Implicit throughout this Methodology is the belief that regulation should facilitate capital formation and economic growth. In the context of regulation, there should also be recognition of the benefits of competition in the marketplace.

It is possible to identify general attributes of effective regulation that are consistent with sound economic growth:

- there should be no unnecessary barriers to entry and exit from markets and products;
- markets should be open to the widest range of participants who meet the specified entry criteria;
- in the development of policy, regulatory bodies should consider the impact of the requirements imposed;
- there should be an equal regulatory burden on all who make a particular financial commitment or promise."[2]

PROPOSED CLOSED-END FUND AMENDMENT IMPACTS ON STAKEHOLDERS

Canadian securities regulatory authorities have a mandate to protect Canadian investors from unfair, improper or fraudulent practices and to foster fair, efficient capital markets as well as confidence in those markets. We believe that a corollary to this mandate is ensuring a regulatory framework that allows the development of healthy, diverse investments by investment dealers that can facilitate the effective deployment of capital for issuers and the creation of wealth for investors. With this in mind, we believe that effective regulation means that CSA members must meet their respective mandates in a cost-efficient manner, not just in terms of running the commissions, but in terms of the effect on registrants and issuers.

While balanced mutual funds are expected to provide all-in-one diversification, this does not mean that retail investors would benefit if closed-end funds were the same as these conventional mutual funds. In fact, closed-end funds are structured for particular purposes and particular client profiles, and are marketed and sold on that basis. IIROC rules and the client relationship model (CRM) require industry professionals with extensive experience and recognized qualifications to take into account the clients' portfolio holdings as a whole, personal profile and preferences, etc.

While we know that the securities commissions are committed to responsive regulation, we believe that there are contradictions in the Proposed Amendments with respect to closed-end funds from the perspective of investors, issuers and intermediaries, described below.

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[2] September 2011, p. 13, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf.

1. **Investor benefits:** We do not understand the rationale in the Proposed Amendments for the duplication we see in the layering of new product-specific regulatory requirements on closed-end funds on top of new CRM enhanced suitability and compensation reporting rules. The effect on investors of regulatory duplication is negative.

   We agree that investors want and deserve a well-regulated system; however, we believe that they have one and that they equally have considerable interest in access to a broad range of services available at a reasonable price through a competitive marketplace. The results of increasing costs of regulation generally may be passed on in prices or may lead some dealers to discontinue certain lines of business or to focus on clients with larger portfolios, none of which results is in a client's best interests.

   What investors could lose would be access to a broader range of asset classes and investment strategies (e.g., credit, institutional trading, leverage, short-selling) designed to meet specific investor objectives, including monthly or quarterly cash income.

2. **Issuer needs:** The finance ministries of a number of provinces and the federal government, the CSA and a number of individual securities commissions have expressed concerns regarding capital-raising, particularly for small and medium-sized enterprises. One aim of NI 51-103, *Ongoing Governance and Disclosure Requirements for Venture Issuers* (albeit it not to be pursued now), was to allow venture issuers to focus more on the growth of their business "by reducing the time venture issuer management must spend reading and trying to understand disclosure requirements" through reducing the overall length and complexity of the instruments, tailoring requirements, streamlining/reducing disclosure redundancies, and enhancing investor confidence in the venture market by introducing substantive governance standards. The Alberta, B.C., Ontario and New Brunswick Securities Commissions at least, in one fashion or another, are investigating regulatory streamlining pertaining to crowd-funding and/or other funding options, including consideration of an audit requirement elimination due to cost. It is difficult to understand why "less is best" for capital-raising in some cases, but not in the case of closed-end funds that serve some of the same small capital-raisers.

3. **Intermediary considerations:** The CSA explains the Proposed Amendments as intended to level the playing field and limit regulatory arbitrage; however, the discussion paper does not provide clear evidence that we can see of regulatory arbitrage and there *is* already a level competitive playing field. Investment fund managers can, and do, offer conventional mutual funds or closed-end funds or both, as in the case of one of the few respondents to Staff Notice 81-322. We note also that this respondent to Staff Notice 81-322 may have requested a "level playing field" due to the firm's general concerns regarding what the firm may perceive as regulatory costs, beyond what is needed for investor protection, associated with conventional mutual funds. This is considered further under Cost-Benefit Assessment below.

COST-BENEFIT ASSESSMENT

The IIAC was very pleased to see in the OSC's final 2013-2014 priorities that "A key part of [the CSA's] plan is to improve [its] cost-benefit analysis of regulatory proposals and to improve the quality of this critical tool." We hope that the CSA will have taken advantage of the extended comment period to make public additional information of relevance, such as complaints or infractions with respect to closed-end funds, which we believe to be few or non-existent.

1. A reasonable approach

We believe that the purpose of the requirement for a cost-benefit analysis in the case of securities legislation is to ensure unintentional consequences are avoided through a sharing of, if not quantified benefits and costs that led to the planned regulation, then at least some clear examples of the types of benefits and costs that may result. We think that, while investors in the Canadian securities marketplace faced significant market volatility from and following the 2008 financial crisis, they did not experience (from what we have been able to derive from CSA and IIROC enforcement statistics) the abuses that were evident in other countries. IIROC's open case assessment files have declined since 2008 and the CSA's cases have averaged 142 annually, only 15% of which are attributed to registrants, few of which are IIROC dealers or advisors. This suggests to us that the benefits for investors from the Proposed Amendments are over-stated.

2. Broader understanding of costs

In terms of costs to investors, beyond the direct expenses of regulation (fees paid to regulators), there are other costs to consider. As noted, these include the likelihood that indirect costs will be passed on as well as the opportunity costs of potential reduced investor choice and access to investments. There are significant internal compliance costs to manage due to the growing amount of regulation. In early 2008, the estimated number of new securities-related rules announced, out for comment, under review or in implementation, which affect dealers directly or indirectly, totaled 28. Today, and excluding tax and other non-securities-regulatory-specific changes, there are over 80 – a tripling – in mainly CSA proposals or IIROC proposals awaiting CSA approval. These rules are in addition to the rules that were introduced and have been fully implemented since 2008.

3. Overlooked benefits

Our members agree that regulation is an important aspect of investor protection and the enforcement/case statistics provided above show that regulation is working. However, we believe that securities regulation can be more effective if those regulating and those regulated have time to plan for changes carefully. This is because there is a limit to how much change can be absorbed efficiently.

For the CSA to help investors and contribute to confidence in the markets, we believe that even considering changing closed-end funds into something closer to conventional mutual funds, as the Proposed Amendments aim to do, can wait for a period of "regulatory stabilization". This is because retail investors are protected under the enhanced suitability and other investor protection provisions of the new CRM requirements further to NI 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. As well, clients of firms regulated, and advisers registered, by IIROC have recourse to accessible redress mechanisms (Ombudsman for Banking Services and Investments (OBSI), IIROC and the commissions, as well as to the Canadian Investor Protection Fund (CIPF) in a closure scenario).

Stabilization is a well-known and prudent best practice in good project management. That is, we believe that there is a need for a time when no new changes are introduced except for emergency investor situations or where other commitments apply (the prudential work under Canadian regulators' commitments to the G-20/Financial Stability Board as regards over-the-counter (OTC) derivatives). Such a maintenance period would allow regulators to make decisions regarding the many items on which comments have been received that are still pending and to evaluate what has been achieved by, for example, the CRM. It would allow a structured assessment of existing rules to identify and correct for any unintended consequences of current regulations. For regulated entities, such as conventional mutual and closed-end fund managers, a period of stabilization would be used to better plan, develop and test new systems and train personnel to support new compliance requirements. It is a time to prepare to explain to clients the significant cost, compensation and performance reporting changes that are still coming and to optimize results overall.

PROPOSED AMENDMENTS WITH WHICH THE IIAC AGREES

Before addressing the CSA's detailed questions in the Annexes in the Proposed Amendments, below is a list of matters in the Proposed Amendments with which we agree, with text in italics where we provide some additional clarification:

a. Conflict of interest provisions under Part 4 of NI 81-102, *assuming they are simplified and made uniform among NI 31-103 – Registration Requirements, NI 81-102 – Mutual Funds and NI 81-107 – Independent Review Committee*

b. Securityholder and regulatory approval for fundamental changes, extending the application of Part 5 of NI 81-102, including:
   i. codifying investor voting rights and
   ii. obtaining regulatory approval for a change in control,

   assuming fund managers are not obligated to pay for expenses associated with regulatory changes or changes primarily benefiting the unitholders in the view of the fund's Independent Review Committee

c. Proposed new securityholder approval requirements under Part 5 including with respect to approvals for:
   i. implementing changes described in the Proposed Amendments to the nature of an investment fund, *assuming fund managers are not obligated to pay for expenses associated with regulatory changes or changes primarily benefiting the unitholders in the view of the fund's Independent Review Committee*
   ii. permitting a non-redeemable investment fund structured from inception to convert to a mutual fund upon the occurrence of a specified event provided there is full and plain disclosure of this feature before the fact *(see also comments in 8.1 below)*;
   iii. allowing fund mergers of limited life specialized non-redeemable investment funds that do not list or trade their securities on a secondary market;
   iv. permitting a merger of a non-redeemable investment fund with another investment fund without securityholder or regulatory approval provided investors can exit the fund at NAV; and
   v. terminating a fund no earlier than 15 days and no later than 30 days after filing a press release to disclose the intended termination

d. Custodianship requirements as in Part 6 of NI 81-102

e. Redemption requirements under Part 10 of NI 81-102 mandating non-redeemable investment funds that offer redemptions *(provided that the price of the offering is based on the most recently determined NAV less costs or on net realized proceeds and costs are clearly disclosed)* to:
   i. send investors a reminder or otherwise advise them annually of the procedures for exercising redemptions;
   ii. pay redemption proceeds no more than 15 business days after the redemption is effected;
   iii. not redeem securities at an amount greater than NAV on the redemption date to avoid dilution subject to our comments in Annex A in response to question 9; and
   iv. permit non-redeemable investment funds offering redemptions to suspend redemptions if the requirements in section 10.6 of NI 81-102 are met

f. Prohibition on the commingling of cash under Part 11 of NI 81-102 by requiring monies from sales and redemptions to be held in a trust account *or be equally protected (for example, and while appreciating the carve-out for IIROC dealers, 'equally protected' could mean through the use of certain qualified transfer agents or where transactions are cleared and settled through CDS Clearing and Depository Services Inc.)*

g. Record dates set as in Part 14 of NI 81-102, except that non-redeemable investment fund listings on an exchange would follow the applicable exchange rules regarding record dates *and,* *as discussed, it should be made clear, perhaps in the Companion Policy, that Part 14.1 should not apply to mutual fund roll-over transactions by flow-through funds*

h. Sales communication requirements under Part 15 of NI 81-102 for the presentation of past performance data for a mutual fund converted from a non-redeemable investment fund for the period when it existed as a non-redeemable investment fund

i. Non-redeemable investment funds maintain and make available securityholder records in accordance with Part 18 of NI 81-102, *except that Part 18.1 should not apply to limited partnerships*.

We are not commenting on a small number of points, such as warrant offerings or securities lending compensation, where we defer respectively, to the issuers and managers that we believe are more appropriate parties to comment, or on such provisions as seed capital and subscription requirements, where the CSA's stated intention is to maintain current regulatory differences between conventional mutual and closed-end funds.

ANNEX A:
SPECIFIC QUESTIONS OF THE CSA RELATING TO THE PROPOSED NI 81-102 AMENDMENTS

Note: *The CSA questions in boldface below have been abridged for easier review of responses. Also, additional commentary has been added regarding matters with respect to which questions were <u>not</u> asked, in the general order in which these matters appeared in the Proposed Amendments. We believe that any items not referred to above require considerably more discussion and therefore strongly agree that they and, as noted in the Proposed Amendments, "… particularly certain proposed investment restrictions that are interrelated with NI 81-104, will require more time to consider and evaluate." We support their being "… considered in conjunction with any related amendments to NI 81-104 and to come into force contemporaneously at a later date." and we draw attention to our request for grandfathering in key areas for this review-and-further-consultation period.*

Annual Redemptions of Securities Based on NAV

1. ***We seek feedback on whether the CSA should reconsider its present view and consider an investment fund to be a mutual fund if it offers any redemptions based on NAV.***

   In the summary of the Proposed Amendments, the CSA recognizes that non-redeemable investment funds differ from mutual funds and, in particular, conventional mutual funds, in certain key aspects. We believe that there are different markets for conventional mutual funds and closed-end funds. **We suggest that the availability of annual redemption at NAV is not a compelling reason to change the CSA's view or approach.** This is particularly the case since NAV is not a consideration when an investor monetizes his or her investment on the exchange:

(i) To the extent that units trade on the TSX at a discount to NAV, the retraction right provides unitholders with a mechanism to dispose of their units for NAV;

(ii) To the extent that units are thinly traded, the retraction right provides unitholders with a mechanism to liquidate a large holding at NAV; and

(iii) The retraction right tends to ensure that units trade closer to or above NAV, since new or existing investors will be more incented to purchase units on the TSX that may be trading at a discount to NAV if they know that they can sell the units back to the fund at NAV in the future. Indeed, evidence supports that U.S. closed-end funds, which do not have annual retraction rights, tend on average to trade at larger discounts to NAV than their Canadian counterparts.

It would seem counter-productive to enact a rule that discourages managers from providing this important liquidity right to investors.

Investment Restrictions

2. ***Concentration Restriction: We invite feedback on the appropriate balance of the concentration limit in NI 81-102 for non-redeemable investment funds and the concentration limit for non-redeemable investment funds under the alternative funds framework in NI 81-104.***

Over time in the pension arena there has been a move from quantitative limits towards greater reliance on a general prudence standard, meaning investment management should be undertaken in accordance with the principles of security and cash flow management, combined with appropriate risk management practices. Moreover, in certain cases, concentration restrictions could prevent exposure to certain industries through an industry-specific closed-end fund: this is particularly likely as the Canadian stock markets are highly concentrated with 60% of market capitalization from two segments only: energy and financials. Investors arguably are better off investing in a professionally managed closed-end fund with investments in even five companies than in an individual company or companies in the sector, particularly as the managers can use recognized hedging techniques in an effort to reduce volatility and increase income.

We believe that, consistent with the trend from hard rules towards a prudent investment standard in the pension investment area, the well-understood market practice of capping or limiting allocations, as well as the discipline of multi-party selling group reviews, have proven effective safeguards for closed-end fundholders. Moreover, were there unacceptably high concentration ratios, investors would still be fully protected under the CRM's enhanced suitability provisions and clients of IIROC firms would have easy access to the free redress mechanism of OBSI, as well as outcomes from the powers of moral suasion that IIROC (or securities commissions) can exercise. Absent evidence of specific concentration problems to date, in

principle it would be desirable to obtain some years of experience under the new NI 31-103 CRM regime before such restrictions are imposed. That said, our members are considering specific limits in greater depth, and, alternatively, additional disclosure options, and therefore may provide additional comments on this point before the August 23, 2013 response due date.

Our views similarly apply in the context of all investment restrictions, including in physical commodities and other assets addressed below.

****** Note: The foregoing comments apply to our answers to all questions identified with asterisks below. ******

3. ***Investments in Illiquid Assets: The CSA invite comment on the amount of illiquid assets that would be appropriate for non-redeemable investment funds to purchase and hold, and whether non-redeemable investment funds should be given more time than 90 days to divest illiquid assets (please refer to the mutual fund divestment requirements in subsections 2.4(2) and (3) of NI 81-102). ******

Closed-end funds' typical once-yearly redemption feature and tradability between redemption periods reduces such funds' needs for liquidity and permits greater investment in asset classes that are less liquid, as well as strategies that can reduce risk and increase distributions.

The CSA note that many, if not most, non-redeemable investment funds do not invest in a substantial amount of illiquid assets, with the implication being that limits can be introduced without concern. We believe that what this shows, rather, is that the general prudent investment standard is working. We also believe that there may be periods when more illiquid assets will be appropriate for a particular closed-end fund.

Requiring greater liquidity holdings will have an impact at some point on the opportunity for new closed-end funds, and could affect, for example, funding for public-private infrastructure partnerships, venture capital opportunities and other investments bringing economic benefits. Moreover, our concerns would increase if illiquid investments were to be defined in a traditional "no public quotation" way as this would exclude highly liquid over-the-counter traded securities, including bonds or senior loans.

Consistent with the foregoing, we believe prudent investment standards, market practice of capping or limiting investment in illiquid assets and the discipline of the selling group have proven effective in managing concentration risk. Provided that investors receive (as required) appropriate disclosure of material aspects of the investment, including the non-redeemability of the fund at NAV except (usually) once annually, we do not believe that liquid investment requirements, which could cap risk-adjusted returns, are in the investor's best interests. That said, our members are considering whether additional clarity in the definition of illiquid assets is

warranted and, if so, how it might best be achieved, as well as the matter of limits and disclosure. We may provide additional comments on this point before the August 23, 2013 response due date.

*** See Note under 2. above. ***

Borrowing

4. ***We seek comment on whether the proposed requirement for non-redeemable investment funds to borrow from a "Canadian financial institution" is appropriate. ******

We assume that the CSA has concluded that a limit to borrowing from Canadian institutions would not breach the North-American Free Trade Agreement or the spirit of Canada's efforts to lower what could be considered to be trade barriers.

That said, it is prudent for assets held in foreign countries to be financed by borrowings from lenders in those locations. Also, assets may in some cases be lodged in a bottom trust outside of Canada and it may be impossible to get a Canadian bank to lend against assets in these countries. Canadian borrowers can often borrow in foreign markets more cheaply and on better terms, particularly given the large size of certain foreign markets and their preparedness to lend in the case of emerging strategies. As many closed-end funds with global mandates follow on launches by sub-advisors in the U.S., selling arrangements and prime broker relationships are longstanding, and to require these to be displaced would add costs and impede service, which is contrary to investor interests.

We do not believe that foreign lenders are any less likely to scrutinize, monitor and control terms of a loan agreement than Canadian lenders would, and if a closed-end fund is in default of a loan agreement, both foreign and Canadian lenders would seek to enforce their rights under the applicable loan and security agreements. Also, and as said in our answer to 3. above, to base a limit on a review at or over a fixed period of time does not mean that broader funding access may not be needed or indeed wise at some point.

As the ability to borrow outside the country as well as from Canadian institutions diversifies funding sources, is consistent with a prudent investment standard, and does not, in any normal situation, cause disruptions that would add costs for investors, we believe that there should be no limits on borrowing, provided borrowing sources are reasonable. We are pleased that CSA Staff are prepared to consider this issue in greater depth, as we believe that alternatives that would meet the standard of prudence, for example, requiring a closed-end fund to limit borrowing options to lenders regulated as financial institutions.

*** See Note under 2. above. ***

4.1 Leverage

While leverage issues are not specifically discussed in a single question in Annex A, we address them here due to the connection with borrowing. The Proposed Amendments point out that there is no single standard maximum leverage amount among closed-end funds and we understand that, in the past two and a half years, more than 50 closed-end funds have come to market with leverage exceeding the proposed threshold. Also, to consider leverage only as a negative is to ignore that while leverage may be employed to enhance the fund's return, it may also be used to hedge the portfolio from certain risks. Similarly, to limit leverage options is contrary to a prudent investment standard, and to the benefits of diversification. Leverage achieved by other means could allow a fund to hedge exposure in a more cost-efficient manner. Finally, an amendment to NI 41-101, *General Prospectus Requirements* (issued in May 2013) requires enhanced disclosure of the use of leverage by these funds, making it less clear why new limits would additionally apply.

At this point, we (i) recommend against a proposed cash borrowing cap as a percentage of NAV; (ii) are opposed to prohibiting other ways to leverage to improve yield, such as by way of short selling, margin, derivatives and investments in other funds; and (iii) support enhanced disclosure instead. We are pleased to have the opportunity to engage in further consultations with CSA Staff on this matter to see whether there are practical alternatives, for example, as a minimum, clarification that the determination of a total leverage cap would exclude leverage assumed for the purposes of hedging.

******* See Note under 2. above. *******

Investments in Mortgages

5. ***We invite comment on the impact of the proposed restriction on investments in non-guaranteed mortgages for publicly offered non-redeemable investment funds. ******

We understand that there may be some difference of opinion as to whether mortgage investment entities should be under the closed-end fund regime. **If they are *not*, or if there are plans to change the regulatory regime governing these entities so that they are corporations, we believe that this should be announced now so that those currently responding on this point as part of the modernization proposals can comment appropriately. The regulatory reasons for the change may be easily understood, however, we believe that, for transparency purposes, CSA Staff will want to engage with investors so that they may understand why the change is occurring, what the implications a change in regulatory regime will have on the value of their investments, and whether there will be grandfathering provisions. Those in this market may want to know whether there will be a continued flow of new mortgages under the new regime, and in this regard, the Toronto Stock Exchange may be in a better position to provide a view.**

If mortgage investment entities are to remain closed-end funds, the Proposed Amendments would restrict inappropriately, we believe, closed-end fund investment in non-guaranteed mortgages (indeed, guaranteed mortgages, available as *National Housing Act* mortgage-backed security pools, provide income at extremely low risk, to the point that they do not require the structuring and associated costs of the more specialized closed-end funds).

To the extent that this restriction is being considered due to sub-prime non-guaranteed (and even guaranteed, in the case of the U.S.) mortgages being a contributing factor to the 2008 financial crisis, the Canadian mortgage market did not experience outcomes remotely like those in the States and other countries. In this regard, we note that CSA Staff issued Notice 31-323, *Guidance Related to the Registration Obligations of Mortgage Investment Entities*. Beyond the particular issues behind the undiversified funding models (rare in Canada) for banks and equivalents in the U.S., U.K. and other places, it was the lack of appropriate disclosure of the poor mortgage origination practices and significant under- or un-reported mortgage delinquencies and foreclosures that were among crisis-initiating factors. Again, these were and are not comparable problems in this country: a DBRS chart of delinquency rates less than a year ago showed U.S. mortgage payment delinquencies still at 10 times the Canadian rate. We therefore do not see that such funds could fall under the alternative investment fund category. **As noted, if they are to remain within the closed-end fund market, then we would appreciate the opportunity for further discussion to ensure that such funds can continue to be created**.

******* See Note under 2. above regarding investment restrictions generally. *******

Fund-of-Fund Structures ****

6. ***We seek comment on whether a carve-out from proposed paragraph 2.5(2)(a) of NI 81-102 would be effective for enabling an underlying mutual fund to continue to invest in accordance with the investment restrictions applicable to the top fund and, if so, what conditions should attach to the use of the carve-out. Are there appropriate alternative measures to enable an underlying fund that is a mutual fund to follow the investment restrictions applicable to the top fund (a non-redeemable investment fund)?***

   We agree that closed-end funds should continue to be able to obtain exposure to an underlying mutual fund not subject to NI 81-102 under certain conditions, for example, provided that the structure not lead to an increase in net fees for the client and that the structure is not used to get around the intent of investment and other restrictions. The carve-out should be conditional on the underlying fund directly or indirectly having investment objectives and restrictions consistent with those of the closed-end fund, possibly, by way of a carve-out from paragraph 2.5(2)(a) of NI 81-102.

   ******* See Note under 2. above regarding investment restrictions generally. *******

7. ***Should proposed amended paragraph 2.5(2)(c) apply to non-redeemable investment funds that use a fund-of-fund structure? ******

We disagree with requiring underlying funds to be reporting issuers in all jurisdictions where closed-end fund units are offered rather than just in Ontario or Quebec, as disclosure will be available to all parties through SEDAR. For the CSA to adopt an approach that provides no additional reporting, is contrary to the "principal regulator" concept, and adds to issuer and hence investor costs would appear to be a conflict of interest and lead to unnecessary additional expenses for closed-end fund holders.

*** See Note under 2. above regarding investment restrictions generally. ***

7.1 *Additional Comment on Annex A – Securities Lending, Repurchase and Reverse Repurchase Limits ****

There is no specific question in Annex A regarding either (i) restrictions limiting the aggregate market value of securities loaned under securities lending transactions or sold under repurchase agreements (repos) by an investment fund to an amount equal to 50% of the fund's NAV or (ii) prohibiting closed-end funds from including borrowed cash (or portfolio assets purchased with borrowed cash) to calculate the maximum market value of their securities that may be loaned under securities lending transactions or sold in repurchase transactions. However, we believe that our answer to question 2 above in regard to the prudent investment standard applies to these Proposed Amendments as well. From a regulatory investor protection perspective, the focus, we believe, should be issues surrounding collateral and disclosure. With respect to what is prudent, Office of the Superintendent of Financial Institutions (OSFI) Guideline B-4, Securities Lending, lists acceptable collateral as including:

> cash; widely-traded debt instruments having a rating of single A (or the equivalent) or higher from a recognized, widely followed North American credit rating agency; commercial paper rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; acceptances of banks and trust and loan companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; high quality common and preferred shares; unconditional, irrevocable letters of credit that comply with the standards of the International Chamber of Commerce and which are issued by banks and trust and loan companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency; and unconditional and irrevocable guarantees of banks and trust and loan companies whose short-term deposits are rated A-1 or R-1 or the equivalent by a recognized, widely followed North American credit rating agency. Equivalents are provided for other countries that are OECD members.

As well, collateral must be held in amounts equal to 105% of the value of securities lent, however, this threshold can vary depending on market practice (it was 102% prior to 2007).

Securities lending, repos and reverse repos can create desirable exposures and should not be limited assuming a prudent investment standard. We believe recourse to repos to create leverage should not be impeded in favour of requirements that apply to conventional mutual fund management, to the extent that this would increase costs or reduce incremental returns for no material net investor benefit. We hope to have further discussion on this matter and may provide additional comments on this point before the August 23, 2013 response due date.

*** See Note under 2. above regarding investment restrictions generally and responses to Annex B below. ***

Organizational Costs of New Non-Redeemable Investment Funds

8. ***Please also comment on whether the capital-raising model followed by non-redeemable investment funds could support the payment of some of the organizational costs out of the proceeds of the initial public offering. Please provide information about these cost components and what fraction each component typically constitutes of the total organizational costs for launching a new fund, and explain why it is appropriate for the fund or the manager to pay the specific cost components.***

The summary of the Proposed Amendments acknowledges that the closed-end fund organizational cost payment model differs from that of conventional mutual funds as closed-end funds raise a fixed amount of money in a limited amount of time, while mutual funds raise funds on a continuous basis, allowing for the recouping of costs over a longer period. The Proposed Amendments say that changing closed-end funds' cost recovery model "could further strengthen the manager's interest in minimizing organizational costs to reduce its initial outlay."

We believe that economic theory suggests that should the compensation model have to be changed, there may be a reduced incentive to launch new funds – diminishing availability – or costs may be passed on to one or more stakeholders in some other fashion. For example, to ensure a recapture of expense, if launch costs were to be recovered over time, it would be typical to see costs increase both by financing charges that are not currently required (and that then would increase as interest rates rise from the current unusually low interest levels), as well as by a form of risk premium to ensure that the manager would receive over time at least the costs expended. This would mean that, to the extent the average closed-end fund hold period is longer than average, these unitholders would pay more than they do under the current model. Alternatively, we may see, and indeed have seen, a deferred sales charge (DSC) fee structure where the manager absorbed all fees and expenses, as well as a higher management fee (and a service fee).

With the current and coming CRM and other requirements for increasingly detailed reporting and disclosure, we believe that the regulators should rely on disclosure and avoid regulation extending into the commercial practice area of *how* to charge, just as the regulators rightly do not see regulating prices through caps as within their ambit. As noted above, all but a fraction of the organizational costs related to regulatory requirements and the final amount relates to travel and meetings to explain the investment (helping address KYP issues) and to promote a larger fund take-up so that ongoing costs remain a proportionally smaller amount per unitholder.

8.1 Conversion to Conventional Mutual Fund

While not asked directly in Annex A, we believe that this issue is related to organizational matters. We do not think that there have been a significant amount of conversions within a relatively short period of issuance, and suggest that analysis might show recent examples as having been clustered among a small number of market participants, with which CSA Staff could engage directly if they had concerns. **For these reasons, we suggest that the CSA establish conditions for conversion from closed-end funds to conventional mutual funds within a short period from issuance, such as a requirement to re-imburse organizational costs, possibly the full amount for a period after the initial closing and a declining amount afterwards.**

8.2 Incentive Fees (Part 7)

While not asked directly in Annex A, we believe that this issue is related to organizational matters. Incentive or performance fees have been used for some time in certain classes of closed-end funds, and are well-understood in the flow-through industry. Also, given the greater multi-party scrutiny that closed-end funds receive in comparison to conventional mutual funds, any non-standard incentive fee terms would be discussed and negotiated at length. Incentive fees are consistent with comments made elsewhere in the Proposed Amendments that the CSA suggest are useful in helping align investment fund manager and investor interests, as these fees normally apply only after certain performance targets or hurdle rates are reached and are common for the highest-quality managers. **As the benefits are shared, and as the incentive fees are disclosed and align manager and investor interests, we believe there should be no restriction on incentive fees at this time. Our members would be willing to work with the CSA to share information on standard performance fee structures if this would be helpful.**

Dilutive Issuances of Securities

9. We invite comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.

The challenge of closed-end funds – and one evident in the relatively static volume of closed-end funds – has been that growth at times has been limited because market practice was that closed-end funds were not re-opened if the effect of new entrants, after accounting for new launch costs, would be dilutive. We agree with the desire not to see existing unitholders disadvantaged by new ones, however, there are some benefits to increased fund size or for issuers, in some cases, to be able to raise more capital, for example, in the area of mining and resources. **We are considering this matter in further depth and may have additional recommendations that could lead to a better ultimate benefit for issuer and investor.**

Naming Convention for Investment Funds

10. Should "Alternative Fund" be in their name? Should investment funds that subject only to NI 81-102 be required to include specific identifiers in their name that would identify them as investment funds that use the conventional investment strategies permitted in NI 81-102?

We believe that the CSA would agree that it would be inappropriate for investors to make investment decisions on the basis of a name alone. The naming protocol proposed by over-generalizing would be misleading. **Therefore, absent a better solution, we believe that the current naming conventions should remain at this time.**

To the extent that the CSA's analysis suggests investor confusion about an important feature of an investment, we believe that, beyond the IIROC investment advisor disclosures, either SEDAR or CSA documentation (or both) present the easiest and quickest solution for investor use. That is, it would appear simplest for CSA members clearly to note, and to require filers to identify, the security type in boldface print on the first page of a prospectus as a 'non-redeemable fund' or – as perhaps better-known to the marketplace – 'closed-end fund' (although neither are fully accurate descriptors), specifically,:

1. In documents filed on SEDAR:
   a. In the Preliminary and Final Long-Form Prospectuses
   b. In the Decision Document (Receipt)

2. When SEDAR is updated:
   a. By adding a field for 'security type' for easier investor use (as an interim measure, it may be more straightforward to change the 'file format' field to 'security type' to differentiate between conventional, closed-end and alternative funds)
   b. By allowing full searchability by document-type, with a legend or pop-up for security types.

As well, we believe that the CSA could provide a one-page plain-language table of the primary differences between mutual, closed-end, exchange-traded and alternative funds to help inform, without overwhelming, investors.

Transition Period for Investment Restrictions in Proposed Amended NI 81-102 and Alternatives

11. ***We invite feedback on whether the proposed transition period is sufficient. Please also comment on the impact a grandfathering provision could have on fairness to new market participants and investor understanding.***

    As we disagree with the lack-of-level-playing-field premise for the Proposed Amendments and cannot subscribe to the rationale provided, in the absence of data, for limit-related and certain other of the proposed changes, we similarly disagree with the need for a transition period and, in particular, for the very short period proposed. The material changes discussed above could never have been anticipated and, unlike in the case of tax legislation where investors can expect changes from time to time (and these sometimes still have very long transition periods or full grandfathering):

    - From the perspective of **issuers** seeking to raise capital, we presume that a reduced amount of financing will be accessed or that it will cost more or have less favourable terms on the assumption that the closed-end fund structure were at the time the most cost-effective way for the particular issuer to raise sufficient money.

    - From the perspective of **investors** in the closed-end funds that would be subject to new restrictions (one closed-end fund has been in existence since 1928 and another since 1965), there may be lower returns and/or higher risks. We believe that, even with transition rules, the proposed changes are effectively retroactive rules. A standard tax policy principle is that retroactive change that is not in the taxpayer's favour should be avoided or at worst only be used in exceptional circumstances; the Joint CBA/CICA Taxation Committee has referred to retroactive changes as "repugnant to taxpayers generally". While tax and securities rules are different, we believe the same principle of the need to avoid retroactivity applies, and so do not see how the CSA can in good conscience intervene in beneficial-to-client arrangements entered into in good faith, with full and fair disclosure.

      Moreover, in terms of fairness between holders and non-holders of the grandfathered closed-end funds, non-holders at the point of transition to the new regime will have an opportunity to buy grandfathered shares in the marketplace, admittedly at what could be expected to be a higher price. It is not apparent to us that the CSA's investor protection role is achieved by bringing the potential returns of investors holding closed-end funds down to the level of those not holding these funds at the time of the regime change.

Finally, the proposed changes may lead investors and potential investors in, and issuers of, closed-end funds to suspect problems with closed-end funds where none existed, further reducing price and interest respectively. This outcome would be directly contrary to the securities commissions' mandate of supporting efficiency and building confidence in Canadian capital markets.

- While not mandated concerns of the CSA, the proposed measures would, we believe, lead to at least some reductions in jobs and tax revenues.

Certainly, the ability to get investor approval for amendments that they may not see as being in their interests is questionable and neither investors nor fund managers should pay for processes that would be required to put specific unwanted provisions of the Proposed Amendments into effect.

Furthermore, we wonder if the CSA has considered whether some financial liability might accrue to the commissions and, if complaints were found to have substance, how awards would be paid in a way that would not directly or through higher regulatory fees inappropriately affect issuers, investment fund managers, investment dealers or investment advisors, or be borne inappropriately by the broader taxpayer base.

That said, while we strongly believe grandfathering of investment and other material provisions applying to closed-end funds is necessary, it will necessarily lead, for a time at least, to investor, issuer and registrant confusion and run counter to a perception of Canadian capital markets as fair.

While certain changes may be appropriate without any, or with limited, grandfathering, investors have incurred the up-front costs discussed above to invest in closed-end funds, in reliance on the particular investment strategy described in the related prospectus. It is unfair, we believe, and contrary to CSA members' commitment to investor protection, to impose retroactively investment and other restrictions that would affect materially the manager's ability to execute the strategy of the particular closed-end fund that the investor has chosen. It is therefore critical, in our view, that existing closed-end funds, and those issued in the NI 81-104 review-and-consultation period, be grandfathered and not have to adopt new investment restrictions provided there is clear disclosure of what investment limits the fund may adopt.

We would be pleased to work with the CSA regarding research that may be required to help move this issue forward. Given that the possibility of significant changes to closed-end funds will place (and may already have placed) a chill on the market (June, which is typically one of the busiest issuance months of the year, saw only two offerings), we thank you for the opportunity to work with CSA Staff this summer to identify a workable solution(s).

Anticipated Costs of the Proposed Amendments and of Implementing the Alternative Funds Framework

12. ***Do you agree or disagree that the costs of the Proposed Amendments and the proposals relating to NI 81-104 are proportionate to the benefits?***

We disagree at this time that costs of the Proposed Amendments are proportional to benefits as far as we can determine from information made available in the Proposed Amendments and other public information cited above in the Cost-Benefit Assessment commentary and hope that the extension in the comment period will allow time for the CSA to investigate their databases for enforcement actions that evidence risks that the CSA identifies with closed-end funds. **We believe that, barring new evidence being provided of closed-end fund problems:**

1. **The direct and indirect costs of the Proposed Amendments materially outweigh the benefits for investors and issuers;**

2. **Any concerns of conventional fund managers with respect to the need for a level playing field may be less closed-end funds and more regulation than they believe is required for investor protection purposes; as evidence, not only *may* any asset manager launch closed-end funds, several have done so (Manulife, Mackenzie and CI funds);**

3. **Closed-end funds, as we believe we have shown, are materially different from conventional funds in terms of their target markets, means of coming to market, and IIROC registered advisor involvement – especially with the ongoing implementation of CRM; and**

4. **Further change in our capital markets, without a clear and present need, will be confusing and reduce rather than add to confidence in our capital markets.**

Economic theory would suggest that adding restrictions that bring closed-end and conventional mutual funds more closely into alignment will eliminate benefits for some investors and create barriers to entry that both will discourage new market entrants while encouraging some to exit the market. We appreciated CSA Staff clarification that this is not the intent, and that efforts are targeted at clarifying differences and understanding market workings. While in certain cases, fund managers could choose to issue either a conventional mutual fund or a closed-end fund, we do not believe that this is inherently bad, nor has there been a reason presented for ensuring no overlap. However, uncertainty regarding what will fall on which side of the mutual-fund/alternative investment fund divide can be expected to have some negative impact on the issuance of closed-end funds until certainty is restored.

And the lack of clear permanent grandfathering of all existing and any follow-on closed-end funds issued would be directly contrary to fair and efficient capital markets and harm confidence in the Canadian marketplace.

ANNEX B:
SPECIFIC QUESTIONS OF THE CSA RELATING TO THE ALTERNATIVE FUNDS FRAMEWORK IN NI 81-104

Developing responses to questions in Annex A was complicated by the fact that investment restrictions may place a closed-end fund on either the conventional mutual fund or alternative investment fund side of the divide between what the CSA appears to be identifying as mutual funds appropriate for retail investors (conventional and 'less risky' closed-end funds) and the Alternative Fund Framework (remaining closed-end funds with alternative classes of funds). That said, many of our comments in reply to the questions in Annex A similarly apply to NI 81-104 alternative funds, although NI 81-104 proposals are insufficiently specific for us to provide formal comments in other than a very few areas (for example, counterparty exposure arising in alternative fund classes would be useful to assess).

We agree that the development of and growth in new alternative asset classes and strategies, as well as increasing investor awareness of and interest in such investments due to continuing low yields, demands an update and expansion of NI 81-104, *Commodity Pools* to capture other forms of alternative funds, that is, other than conventional open and most, if not all, closed-end funds. **However, without more information, we are not persuaded of the need for limits on concentration, illiquid assets, derivatives use, leverage, borrowing, securities lending and so on in a way that would negatively impact the market for these funds. There may be a need in the future for the scope to undertake certain activity in a way we do not now realize, and there should be some scope in the rules for flexibility as later having to change the rules would be extremely time-consuming.**

Also, we strongly do not believe that there needs to be a different or new *process* for additional proficiency requirements to distribute closed-end or even alternative funds than exists already for IIROC advisors. Currently, IIROC and its Education and Proficiency Committee, which reports to IIROC staff, is mandated to advise on the development and maintenance of proficiency standards for investment dealers and their approved persons, and to establish processes for accreditation of course providers and/or their products. We believe that this process works: proficiency requirements are best updated, and the updates are likely to be more timely, if the CSA continues to rely on this IIROC-based approach for IIROC dealer staff.

For the CSA to try to identify new areas and new skills for products just emerging, or that may emerge, is likely to be less successful than using the individuals working in the industry, many of whom have their CFA designation and must adhere to the CFA code of conduct. While the rule aims to regulate the investment fund product, we believe that KYP, KYC, enhanced suitability and other CRM provisions work to protect investors even as new products with different features develop. Should there be some benefit for CSA Staff from additional data-gathering to address a specific concern, we would be pleased to work with you to determine what data would be helpful and can reasonably be obtained.

ANNEX C
SPECIFIC QUESTIONS OF THE CSA RELATING TO SECURITIES LENDING, REPURCHASES AND REVERSE REPURCHASES BY INVESTMENT FUNDS

See Annex A, 7.1 above.

We believe that if concerns that proposed changes in Annex C seek to address arise from experience in other countries, there may be some opportunity to respond to these issues by other means (or they may already be addressed by IIROC rules). **We request the CSA to provide relevant examples of new requirements introduced by IOSCO countries that are relevant to the Canadian situation and look forward to working with CSA staff on these matters.**

CONCLUSION

We understand and support the laudable intention of the CSA's efforts to protect investors while maintaining fair and efficient capital markets and agree with the core requirements with the suggestions noted. On the basis of information provided, however, we believe that the case for added investor protection has not been made in the Proposed Amendments for new investment and other restrictions on the basis of material prudential gaps or a lack of clarity causing confusion. Nor have we been able to identify areas where Canada's rules are lacking from a prudential perspective, meaning they should meet or go beyond those of other IOSCO members whose closed-end-fund markets may operate differently.

Rather, IOSCO's *Principles for the Regulation of Exchange-Traded Funds Final Report* (June 2013) focuses on disclosure, and this is an approach with which we agree. This principle is also reflected in the IOSCO Assessment Methodology, which, as stated above, recognizes that "… inappropriate regulation can impose an unjustified burden on markets and inhibit market growth and development… [and] that regulation should facilitate capital formation and economic growth [and recognize] the benefits of competition in the market place."

We believe that moving from three (conventional, closed-end and alternative funds) to two categories (1. conventional mutual and some closed-end funds and 2. other closed-end and alternative funds) by imposing new restrictions will reduce choice, access and competition, which are outcomes contrary to investor interests. For these reasons, we recommend making the changes above with which we agree and clarifying that no changes will be made for the period of time necessary to consult fully on alternative funds, after which time any new regulation will grandfather then existing funds (and any follow-on capital raising).

TOP 35 CLOSED-END AND CONVENTIONAL MUTUAL FUNDS BY AUM: TOTAL RETURN PERFORMANCE COMPARISON

Closed-End Funds[1]	Ticker	AUM	Inception	5-Year Total Return Performance[2]	Open-End Mutual Funds[3]	AUM	Inception	5-Year Total Return Performance[2]
EnerVest Diversified Income Trust	EIT	$1,001	8/6/1997	16.06%	Investors Dividend Fund	$12,900	7/1/2003	20.59%
Marret High Yield Strategies Fund	MHY	$648	6/17/2009	22.52%	Fidelity Canadian Asset Allocation Fund	$8,975	12/30/1994	4.63%
Economic Investment Trust Limited	EVT	$365	4/3/1928	-11.54%	Fidelity Canadian Bond Fund	$8,002	2/1/1988	27.30%
Timbercreek Senior Mortgage Investment Corporation	MTG	$353	1/19/2012	-0.90%	Signature High Income Fund	$4,990	12/1/1996	38.44%
Timbercreek Mortgage Investment Corporation	TMC	$350	7/4/2008	43.07%	Investors Income Plus Portfolio	$4,700	7/1/2003	14.24%
Dividend 15 Split Corp.	DFN	$347	3/15/2004	40.04%	BMO Monthly Income Fund	$3,408	5/22/1999	19.43%
Marret Investment Grade Bond Fund	MIG	$326	10/22/2009	19.68%	Harbour Fund	$3,392	6/1/1997	4.05%
Aston Hill VIP Income Fund	VIP	$323	2/18/2002	17.24%	BMO Dividend Fund	$3,310	10/3/1994	6.17%
OCP Senior Credit Fund	OSL	$309	11/18/2010	13.68%	Sentry Canadian Income Fund	$3,151	2/15/2002	47.42%
ING Floating Rate Senior Loan Fund	ISL	$297	6/17/2011	10.43%	Investors Canadian Bond Fund	$3,100	7/1/2012	22.81%
SCITI Trust	SIN	$284	4/28/2003	34.39%	Manulife Strategic Income Fund	$3,019	11/30/2005	56.42%
Blue Ribbon Income Fund	RBN	$283	9/16/1997	72.26%	Harbour Growth & Income Fund	$2,707	6/1/1997	2.84%
OCP Credit Strategy Fund	OCS	$266	11/19/2009	15.74%	Signature Income & Growth Fund	$2,603	11/1/2000	21.09%
Symphony Floating Rate Senior Loan Fund	SSF	$261	11/1/2011	17.74%	Quotential Balanced Growth Portfolio Fund	$2,580	8/19/2002	9.08%
Life & Banc Split Corp.	LBS	$240	10/16/2006	15.38%	Fidelity Canadian Disciplined Equity Fund	$2,276	9/30/1998	-6.79%
Trez Capital Mortgage Investment Corporation	TZZ	$221	6/4/2012	1.36%	Fidelity American High Yield Fund	$2,237	2/7/1994	52.95%
Canso Credit Income Fund	PBY	$202	7/16/2010	24.99%	Signature Select Canadian Fund	$2,197	5/1/1998	6.41%
INDEXPLUS INCOME FUND	IDX	$198	8/14/2003	51.71%	CI Canadian Investment Fund	$2,187	11/1/1932	3.54%
CanBanc Income Corp	CIC	$194	8/18/2010	16.45%	Signature Diversified Yield Fund	$2,165	11/1/2009	20.67%
Can-60 Income Corp.	CSY	$176	10/18/2010	-3.90%	Investors Canadian Large Cap Value Fund	$2,100	7/1/2003	-12.47%
YIELDPLUS Income Fund	YP	$171	9/14/2004	23.69%	Investors U.S. Large Cap Value Fund	$1,900	7/1/2003	19.38%
Financial 15 Split Corp.	FTN	$163	11/13/2003	17.39%	Mackenzie Sentinel Corporate Bond Fund	$1,669	11/1/2000	42.05%
Brompton Split Banc Corp.	SBC	$159	11/15/2005	55.48%	Templeton Growth Fund	$1,421	11/29/1954	11.63%
Front Street U.S. MLP Income Fund Ltd.	MLP	$159	12/8/2010	21.34%	Quotential Diversified Income Portfolio Fund	$1,371	6/23/2008	27.09%
ING Diversified Floating Rate Senior Loan Fund	IFL	$158	3/22/2013	0.65%	Trimark Global Equity Fundamental Equity Fu	$1,293	8/1/2007	-2.82%
Preferred Share Investment Trust	PSF	$155	4/2/2009	38.15%	IG Mackenzie Income Fund	$1,260	9/1/1999	24.05%
MINT Income Fund	MID	$151	3/13/1997	38.54%	Signature Canadian Balanced Fund	$1,250	6/1/1997	15.76%
Sentry Select Primary Metals Corp.	PME	$143	6/13/2007	16.85%	Select Income Managed Corporate Fund	$1,178	7/1/2010	18.50%
Sprott Strategic Fixed Income Fund	SFI	$139	7/19/2011	-4.97%	Manulife Corporate Bond Fund	$1,139	8/28/2003	43.81%
Picton Mahoney Tactical Income Fund	PMB	$138	10/18/2012	4.62%	BMO Monthly High Income Fund II	$1,136	10/10/2002	33.06%
Canadian Life Companies Split Corp.	LFE	$137	4/15/2005	-81.59%	Quotential Balanced Income Portfolio Fund	$1,132	8/19/2002	14.27%
Newgrowth Corp.	NEW	$136	6/26/1992	52.56%	Manulife Simplicity Balanced Portfolio Fund	$1,101	8/23/2001	6.86%
First Asset Canadian REIT Income Fund	RIT	$134	11/12/2004	70.29%	Manulife Diversified Investment Fund	$1,043	6/27/2008	28.90%
Aston Hill Advantage VIP Income Fund	AV	$132	2/14/2006	23.92%	Manulife Simplicity Growth Portfolio Fund	$955	8/23/2001	-1.46%
HBanc Capital Securities Trust	HSC	$132	10/12/2010	14.29%	Investors Canadian Equity Fund	$783	12/1/2004	-26.08%
		Average (Top 35):		20.22%		Average (Top 35):		17.54%

Notes:

(1) Closed-end funds exclude funds that are solely commodity funds.

(2) 5-year total return performance measures the period from June 4, 2008 to June 3, 2013. If the fund began after June 4, 2008, the performance represents the total-return performance of the fund since

(3) Open-end mutual funds exclude funds that are money market funds.

Source: Ranking - Globeinvestor.com - Fund Filter; Performance - Bloomberg; AUM - Company websites.