PERISCOPE
CAPITAL

DELIVERED VIA EMAIL

July 11, 2011

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
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 Territory
Superintendent of Securities, Nunavut

c/o

John Stevenson, Secretary
Ontario Securities Commission
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- and -

Me Anne-Marie Beaudoin
Corporate Secretary
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Dear Canadian Securities Administrators:

Periscope Capital Inc. – Comments on 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

Periscope Capital Inc. ("**Periscope Capital**" or "**we**") appreciates the opportunity to submit this comment letter on 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 (the "**Staff**

Notice"). Capitalized terms used and not defined in this comment letter have the meanings given to them in the Staff Notice.

A. BACKGROUND ON PERISCOPE CAPITAL

Periscope Capital is registered as a portfolio manager, exempt market dealer, investment fund manager, commodity trading counsel and commodity trading manager in the Province of Ontario and as an exempt market dealer in the Provinces of Quebec and New Brunswick. We provide investment advisory services to institutional and high net worth investors. Our investment strategies focus on the Canadian capital markets and include investing in securities issued by various types of publicly offered investment funds.

B. ISSUES FOR COMMENT

Prior to addressing the specific issues for comment, we note that the Canadian investment fund industry is a dynamic sector which strives to develop new products in order to satisfy the needs of the investing public, from sophisticated institutions to retail investors. We take the general view that investment fund regulation should be designed to support the creativity and innovation which the industry has demonstrated over the past several decades, while at the same time ensuring that investment funds provide meaningful disclosure and fair treatment to their securityholders.

This comment letter responds to Issues 1 through 5 as set out in the Staff Notice. Because Periscope Capital does not currently manage or administer any non-redeemable investment funds, we are not in a position to respond to Issue 6 as set out in the Staff Notice.

1. Do you agree with our view that certain consistent, core investor protection requirements should apply equally to all types of publicly offered investment funds? We particularly seek feedback from investors.

As an investor, Periscope Capital agrees with the CSA's view that certain consistent, core investor protection requirements should apply equally to all types of publicly offered investment funds. The requirements which the CSA has identified in the Staff Notice relating to conflict of interest restrictions, securityholder approval and custodianship are primary examples of such core investor protection requirements. We have not identified any legitimate policy basis for excluding non-redeemable investment funds from the application of these core requirements, which represent industry best practices with which most managers of non-redeemable investment funds already comply. Because these core investor protection requirements do not impose any investment restrictions, the imposition of these requirements should not hamper innovation in the non-redeemable investment fund sector.

Periscope Capital submits that another core investor protection measure which should apply to all publicly offered investment funds is a requirement to provide transparency regarding the calculation of proceeds payable upon redemption of investment fund securities ("**Redemption Proceeds**"), particularly in cases where Redemption Proceeds are less than the NAV per security calculated on the date of redemption. This submission is discussed further under Issue 3 below.

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2. Do you agree with our approach to develop a stand-alone operational rule for non-redeemable investment funds? If not, what approach would you propose? What are the advantages and disadvantages of this approach?

Periscope Capital submits that it would be preferable for the CSA to develop one operational rule for all publicly offered investment funds, including mutual funds and non-redeemable investment funds. This rule could distinguish between the various categories of publicly offered investment funds (including conventional open-end mutual funds, exchange-traded mutual funds and non-redeemable investment funds) and clearly identify which provisions apply to each category of fund. This approach offers the following advantages over the development of a stand-alone rule for non-redeemable investment funds:

- user-friendly for industry participants such as lawyers, accountants and investment fund managers who advise or manage numerous types of investment funds;
- ensures consistency in the interpretation and application of the core investor protection requirements which will apply to all publicly offered investment funds;
- simplifies the rule amendment process by reducing the need to make conforming changes across two or more rules;
- applies automatically to any new category of publicly-offered investment fund which may develop in the future; and
- there are successful precedents for this approach, for example National Instrument 81-106 Investment Fund Continuous Disclosure and National Instrument 31-103 Registration Requirements.

3. We seek feedback on the initial restrictions and operational requirements we have identified for non-redeemable investment funds. If you disagree, what restrictions and operational requirements would be appropriate for non-redeemable investment funds and why? If you think no requirements are needed, please explain why.

As stated above in our response to Issue 1, Periscope Capital approves of the initial restrictions and operational requirements which the CSA has identified for non-redeemable investment funds, specifically conflict of interest restrictions, securityholder approval requirements and custodianship requirements. In our view, non-redeemable investment funds should not be required to obtain regulatory approval for fundamental changes, provided that securityholder approval has been obtained.

It may be argued that investors in non-redeemable investment funds are generally more sophisticated than investors in mutual funds and, therefore, these investor protections are not necessary. However, in our view even the most sophisticated investors deserve the benefits of these safeguards for the following reasons:

- **Conflicts of interest.** The structure of the investment fund industry presents myriad opportunities for investment fund managers to place their own interest over that of their securityholders, for example through the types of self-dealing transactions identified in Section 4.2 of NI 81-102. Without regulatory restrictions on conflicts of interest, managers of non-redeemable investment funds have discretion to engage in self-dealing transactions and to

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determine what, if any, public disclosure of such transactions is appropriate. Investors rely on fund managers to provide detailed and accurate disclosure of such transactions so that they can make informed investment decisions.

Although National Instrument 81-107 Independent Review Committees (NI 81-107) establishes a mechanism for the independent review of conflict of interest matters respecting all publicly offered investment funds, initially the onus rests with the manager to identify the conflict of interest and present it to the independent review committee for review. Without regulatory restrictions on conflicts of interest, there is no assurance that managers will appropriately identify all self-dealing transactions as conflicts, or that the independent review committee will be presented with sufficient information regarding the proposed transaction to support an informed decision.

- **Securityholder and regulatory approval requirements.** Securityholder approval of fundamental changes is required of most reporting issuers under applicable business corporation statutes, securities legislation and exchange listing requirements. There is no reason why non-redeemable investment funds should depart from the practices applicable to all other reporting issuers. However, in our view, non-redeemable investment funds should not be required to obtain regulatory approval of the types of fundamental changes set out in Section 5.5 of NI 81-102, provided that securityholder approval has been obtained. Additional costs and time delays would likely be associated with a regulatory approval process, which would not provide significant additional benefits to securityholders.

- **Custodianship requirements.** In the wake of the global credit crisis in 2008, the segregation and security of investment fund assets has become a paramount concern for investors. As set out in the Staff Notice, custodianship requirements have applied to non-redeemable investment funds since the coming into force of Part 14 of NI 41-101 in 2008. Periscope Capital agrees that these requirements should extend to non-redeemable investment funds which were established prior to such time.

Periscope Capital submits that another core investor protection measure which should apply to all publicly offered investment funds is a requirement to provide transparency regarding the calculation of Redemption Proceeds, particularly in cases where Redemption Proceeds are less than the NAV per security calculated on the date of redemption. Currently, disclosure in the prospectuses of most closed-end investment funds states that Redemption Proceeds will be a function of NAV per security less a certain amount of redemption charges to be determined by the fund manager. In most cases, these charges reflect actual or estimated brokerage commissions and other transaction costs which may be associated with the partial liquidation of the fund's portfolio necessary to finance the redemption. However, in some cases investment funds impose additional redemption charges which may not be adequately disclosed in their prospectus or other continuous disclosure documents. In practice, the amount of redemption charges (as a percentage of NAV per security) and the adequacy of disclosure regarding such charges both differ between fund managers, sometimes materially. When deciding whether to invest in a particular non-redeemable investment fund, it would be useful for investors to know the historical practices of the fund manager regarding the calculation of Redemption Proceeds and imposition of redemption charges. Public disclosure of Redemption Proceeds and associated redemption charges would also assist investors who have questions or concerns regarding the actual

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amount of Redemption Proceeds paid, when compared to the NAV per security as of the date of redemption.

4. Are there other investor protection principles and/or requirements of NI 81-102 which the CSA should consider for non-redeemable investment funds at this time? If so, please explain.

Periscope Capital is of the view that the following Parts of NI 81-102, if applicable to non-redeemable investment funds, would provide investor protection benefits without imposing onerous costs or other burdens:

- **Part 10 – Redemption of Securities of a Mutual Fund.** These provisions would require non-redeemable investment funds: (i) to have adequate procedures for processing redemption requests in a fair and timely manner; and (ii) to suspend redemptions only when it is commercially reasonable to do so. We submit that most closed-end investment funds already comply with these provisions in conformity with industry best practices and market expectation.

- **Part 15 – Sales Communications and Prohibited Representations (the "Sales Communications Provisions").** These provisions would ensure that the marketing materials prepared for non-redeemable investment funds, including prospectuses and green sheets, contain relevant information and do not include misleading or unsubstantiated claims. It is our understanding that many of the principles set out in the Sales Communications Provisions are invoked by the CSA when commenting on preliminary prospectuses filed by non-redeemable investment funds. Application of the Sales Communications Provisions would provide certainty to both issuers and regulators regarding what type of disclosure is permissible. However, the Sales Communications Provisions should not prevent non-redeemable investment funds from providing meaningful disclosure to investors regarding a new investment strategy or product which does not yet have a proven history or track record, provided that there is legitimate evidentiary support for such disclosure.

Periscope Capital is of the view that the following Parts of NI 81-102 should not apply to non-redeemable investment funds:

- **Part 3 – New Mutual Funds.** Sections 3.1 and 3.2 are not necessary for non-redeemable investment funds which are generally distributed by a syndicate of dealers pursuant to a "best efforts" agency agreement.

- **Part 7 – Incentive Fees.** In order to encourage innovation, closed-end investment funds should be permitted to enter into all sorts of fee arrangements, provided that detailed, clear disclosure is provided in their prospectuses and continuous disclosure documents.

- **Part 9 – Sale of Securities of a Mutual Fund, Part 11 – Commingling of Cash and Part 12 – Compliance Reports.** These provisions are not necessary for non-redeemable investment funds which are generally distributed by a syndicate of dealers which are members of the Investment Industry Regulatory Organization of Canada (IIROC) and comply with IIROC requirements governing these processes. However, it may be appropriate to require non-redeemable investment funds to prepare compliance reports (as contemplated in Part 12) relating to compliance with the redemption provisions set oiut in Part 10 of NI 81-102, since redemptions are generally not administered by IIROC member firms.

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- **Part 13 – Record Date.** Non-redeemable investment funds should have the flexibility to determine appropriate record dates for establishing the rights of securityholders to receive distributions, provided that the process for making these determinations is clearly disclosed in their prospectuses and continuous disclosure documents.

5. In addition to the initial requirements the CSA has identified for non-redeemable investment funds, we are considering the possibility of imposing certain investment restrictions, similar to those set out under Part 2 of NI 81-102. Please identify those core investment restrictions that, in your view, should apply to these funds and explain why. If you think no investment restrictions are needed, please explain why.

The non-redeemable investment fund industry develops innovative products which satisfy investor demands that cannot be met through investments in traditional open-end mutual funds or exchange-traded mutual funds. New regulation of these funds should not unduly restrict their flexibility to implement creative investment objectives and strategies. As such, in our view the investment restrictions set out in Sections 2.1 through 2.11 of Part 2 of NI 81-102 should *not* apply to non-redeemable investment funds. Investor protection concerns regarding potentially high risks associated with the investment practices which are prohibited or restricted under Sections 2.1 through 2.11 can be addressed by ensuring that prospectuses and continuous disclosure documents are sufficiently detailed and clear.

In contrast, the investment restrictions set out in Sections 2.12 through 2.17 of Part 2 of NI 81-102 would not appear to unduly restrict the flexibility of non-redeemable investment funds. These provisions would permit non-redeemable investment funds to engage in securities lending, repurchase and reverse repurchase transactions but would ensure that such transactions are implemented with appropriate documentation, supervision, controls and records. These requirements reflect industry best practices and are likely already complied with by many non redeemable investment funds.

C. CONCLUSION

Thank you for providing us with this opportunity to comment on the Staff Notice. We look forward to the CSA's continuing progress on Phase 2 of the Investment Fund Regulation Modernization Project.

Best Regards,

"Lori Stein"

Lori Stein
General Counsel & Chief Compliance Officer

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