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VIA EMAIL

July 25, 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

Delivered to:

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Dear Sirs/Mesdames:

RE: CSA Staff Notice 81-322 *Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project* (the CSA Staff Notice) and Request for Comment on Phase 2 Proposals

We are writing this letter on behalf of the Investment Management practice group of Borden Ladner Gervais LLP (BLG). As such, we are pleased to provide the Canadian Securities Administrators (CSA) with this letter commenting on the concepts set out in the CSA Staff Notice, which include the proposals for Phase 2 of the modernization project. Our comments do not necessarily represent the views of other lawyers, the firm or our clients, although we have incorporated feedback received to date from our clients into this letter.

We look forward to reviewing the final revisions to National Instrument 81-102 *Mutual Funds* that were published as part of the CSA's Phase 1 modernization proposals in June 2010. We hope that our comments set out in our comment letter of September 24, 2010 were helpful in developing these final rules.

We wish to provide the following input into the CSA's proposals for Phase 2 of the modernization proposals.

1. Phase 2 should recognize the significant fundamental differences between mutual funds and other forms of investment funds

As part of Phase 2 of the modernization proposals, we believe that generally the adoption of rules and restrictions for non-conventional investment funds in the areas indicated in the CSA Staff Notice should not be controversial, particularly if those rules are largely principles-based. However, we urge the CSA to not simply map over rules that apply to prospectus-qualified mutual funds without considering the fundamental differences between mutual funds and closed-end funds and other forms of investment funds.

There are significant economic and structural differences between these types of investment funds that, in our view, will give rise to justifiable differences in regulation, including:

- Closed-end funds do not give their securityholders the right to "redeem on demand". Closed-end funds therefore do not face the same pressures as mutual funds to maintain liquidity in their portfolio assets and accordingly the rules that relate to protections designed to enhance liquidity for mutual funds would not appear to be necessary.

- Closed-end funds are not in continuous distribution, which means that the portfolio manager of a closed-end fund in managing the fund's assets does not have to deal with the same flow of assets as for mutual funds. Generally a closed-end fund is sufficiently scalable to achieve the fund's investment objectives immediately after the closing of the initial public offering.

- After a primary distribution, securities of closed-end funds are typically purchased on an exchange through an investment dealer. The level of sophistication expended to follow and analyze investments in closed-end funds, both by dealers and investors, is often greater, in many cases, than typical retail mutual funds.

- Currently, closed-end funds are permitted to use leverage to enhance investor returns. In many cases, this leverage is achieved through bank borrowings, with the closed-end fund providing a security interest over its other assets in favour of the bank. In our view, the prohibition on the use of leverage that applies to NI 81-102 mutual funds should not be extended to closed-end funds. We note that the most recent CSA proposals for amendments to National Instrument 41-101 (published on July 15, 2011) will require enhanced disclosure of the use of leverage by these funds. We consider that this enhanced disclosure is appropriate.

- Securities of closed-end funds, after the primary distribution, are usually not traded at net asset value (NAV), but rather trade on an exchange either at a premium or a discount to NAV. If the securities of a closed-end fund trade at a significant discount to the fund's NAV for an extended period of time, the managers of closed-end funds should have the option to take corrective action, including converting to an open-end mutual fund.

2. Consider changes to investment restrictions for mutual funds in line with earlier commentary – Stage 2 of Phase 2

The CSA Staff Notice describes that during Stage 2 of Phase 2, the CSA propose to focus on investment restrictions for conventional mutual funds and to assess what, if any, changes should be made to Part 2 of NI 81-102. As some of the issues that BLG and other commenters have pointed out to the CSA in connection with Phase 1 of the modernization project are issues with certain provisions in Part 2 of NI 81-102 (such as fund-on-funds restrictions and the rules on the use of specified derivatives), we hope that the CSA will revisit these provisions during this stage if they are not addressed during Phase 1.

3. Phase 2 must recognize the entire body of regulation that applies to investment funds, their managers and portfolio managers

We strongly recommend that the CSA take into account the entire regulatory landscape that applies to investment funds and their managers, particularly now that investment fund managers are registered and regulated pursuant to National Instrument 31-103. It is also very important to keep in mind the disclosure requirements of National Instrument 81-106 and the requirements of National Instrument 81-107. Rules that apply to investment funds should not be developed in a vacuum without consideration of this other regulation.

4. Phase 2 should focus on rationalizing the disparate conflicts of interest regime that applies to investment funds, their managers and portfolio managers

As part of the modernization project, we strongly recommend that the CSA consider rationalizing the conflict of interest provisions that apply to investment funds, their managers and portfolio managers in the various jurisdictions of Canada. There is much overlap, inconsistent application, complexities and complications amongst the following securities regulation:

- Securities legislation in many provinces (for example, section 111 in the Securities Act (Ontario))
- Part 4 of National Instrument 81-102
- Section 2.2 (1)(b) of NI 81-102
- National Instrument 81-107 – particularly sections 6.1 and 6.2 of NI 81-107
- Sections 13.4, 13.5 and 13.6 of National Instrument 31-103

In our view, for publicly offered investment funds, it is critical that regulation of conflicts of interest allows for effective and efficient interrelationship with National Instrument 81-107. We have provided earlier commentary to the CSA in connection with the proposals leading up to National Instruments 81-107 and 31-103 in this regard.

5. Consider investment restrictions and practices for all investment funds at the same time

The CSA Staff Notice also indicates that the CSA may also consider additional requirements or restrictions for closed-end funds during Stage 2 of Phase 2. We query whether it would be more efficient and less disruptive for industry participants and investors for the CSA to consider investment restrictions for retail mutual funds, ETFs and closed-end funds all at the same time. In our view, the CSA's proposal to consider certain "core investment restrictions" for closed-end funds as part of Phase 1 of Stage 2 should be deferred to Phase 2 of Stage 2.

6. Consider how the rules will apply to different forms of investment funds

We also urge the CSA to consider all investment funds as part of the modernization project to ensure appropriate universal principles and rules. For example:

- The CSA Staff Notice does not mention scholarship plans specifically, although the Notice speaks more generally to non-redeemable investment funds, of which scholarship plans is one sub-set. It might be best and more efficient to roll the project to reconsider National Policy No. 15, as referred to in the CSA's March 2010 scholarship plan prospectus proposals publication, into the overall project to modernize investment fund regulation. The specific rules that would apply to scholarship plans, if they are different from other non-redeemable investment funds, could be a separate division of the CSA's proposed stand-alone rule governing non-redeemable investment funds.

- National Policy No 29 has not been re-considered by the CSA to our knowledge. We see the CSA's modernization project as an opportunity to modernize the regulation of mortgage funds, and particularly to include common exemptive relief in new updated rules.

7. Consider realities of investment fund securityholder meetings

While we recognize that requirements to seek securityholder approval of certain fundamental changes bring a certain discipline to fund manager actions, we urge the CSA to consider the current level of investor behaviour concerning meetings. Most investors are passive, preferring to "vote with their feet" if they do not approve of a proposed action, rather than attending meetings or even sending in proxies with votes to be counted at meetings. As part of Phase 2, we would encourage the CSA to consider alternatives to holding securityholder meetings, such as enhanced disclosure and advance notice of proposed changes, particularly given the role of independent review committees under NI 81-107. It might be useful for the CSA to obtain real-life feedback from investors and IRC members on securityholder meetings versus other, less costly (to investors), alternatives.

Thank you for considering our comments and we would be very pleased to discuss them with you in more detail.

Please contact any of the following lawyers at the contact information provided below if you have any questions about our comments or you would like to meet with us to discuss them.

Yours very truly,

Borden Ladner Gervais LLP

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