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Superintendent of Securities, Nunavut

c/o

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Dear Canadian Securities Administrators:

Periscope Capital Inc. – Comments on CSA Notice and Request for Comment – 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

Periscope Capital Inc. ("**Periscope Capital**" or "**we**") appreciates the opportunity to submit this comment letter on Canadian Securities Administrators (CSA) Notice and Request for Comment – 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 "**CSA Proposal**"). Certain terms used and not defined in this comment letter have the meanings given to them in the CSA Proposal or in National Instrument 81-102 *Mutual Funds* ("**NI 81-102**").

I. 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 investment fund manager and exempt market dealer in other relevant jurisdictions. We provide investment advisory services to institutional and high net worth investors. Our investment strategies focus on the Canadian capital markets, including publicly traded non redeemable investment funds (commonly referred to as "**closed end funds**" or "**CEFs**") and exchange traded funds.

II. ISSUES FOR COMMENT

This comment letter responds to the Specific Questions of the CSA Relating to the Proposed 81-102 Amendments set out in Annex A of the CSA Proposal in Section A below, and the Specific Questions of the CSA Relating to the Alternative Funds Framework in NI 81-104 (the "**Alternative Funds Framework**") set out in Annex B of the CSA Proposal in Section B below. This comment letter also includes our recommendation regarding an issue which was not raised in the CSA Proposal in Section C below, specifically, that closed end funds which offer annual redemptions at NAV be required to publicly disclose details of their annual redemption process, including transparency regarding the calculation of proceeds payable upon redemption.

Due to the length of many of the CSA's questions, we have not reproduced the questions in full in this comment letter.

A. Specific Questions of the CSA Relating to the Proposed 81-102 Amendments

1. Annual Redemptions of Securities Based on NAV

We submit that the CSA should maintain its present view and **not** consider an investment fund to be a mutual fund if it offers annual redemptions based on NAV. Annual redemptions based on NAV have been a common feature of most CEFs in the Canadian market since this asset class was developed. Currently, at least 90% of CEFs listed on the Toronto Stock Exchange (TSX) provide such annual redemption features. Generally, throughout the history of this asset class, CEFs have always honoured the annual redemption requests submitted by their holders and have managed their liquidity to fund such redemptions. One mechanism which most (if not all) CEFs have adopted to ensure sufficient liquidity to fund annual redemptions is to strike the NAV applicable to the annual redemption sometime after the redemption tender date. Securities regulatory authorities and industry participants who provided input into the CSA Proposal have done so with the understanding that most CEFs offer annual redemptions at NAV.

Under the CSA Proposal, many regulatory distinctions between mutual funds and CEFs have been eliminated and a level playing field has been established. Those regulatory distinctions that remain recognize the different distribution methods used by CEFs and mutual funds, specifically that CEFs are initially sold to the public by a syndicate of investment dealers and are then listed for trading on a stock exchange, while mutual funds do not have a secondary trading market and are continuously distributed by mutual fund dealers and investment advisors using a subscription and redemption process. Mutual fund disclosure forms, such as the Simplified Prospectus and point of sale disclosure, are designed to work within the mutual fund distribution framework. In addition, some investment flexibility which has

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been preserved for CEFs under the CSA Proposal recognizes that CEFs do not have the same liquidity requirements and mutual funds which must fund regular redemptions. To reclassify CEFs which provide annual redemptions at NAV as mutual funds would be to undo much of the CSA's careful work in developing the CSA Proposal, by subjecting CEFs to regulatory requirements and a disclosure regime which were designed for a different asset class. It could also create confusion for mutual fund investors and advisors, who assume that all mutual funds offer daily liquidity at NAV and would be surprised to find funds which offer only annual redemptions at NAV to be classified as mutual funds.

2. Concentration Restriction

If the Alternative Funds Framework is adopted, we submit that it should not include any concentration limit, to provide optimal flexibility for alternative funds (whether they are mutual funds or CEFs) to offer unique and diverse investment strategies which may involve highly concentrated investments. Assuming that this approach to concentration is taken under the Alternative Funds Framework, we suggest that a concentration limit in the range of 25% to 30% apply to CEFs which are not alternative funds to give them investment flexibility while at the same time providing for reasonable diversification. For example, many CEFs invest in a portfolio of five to ten Canadian banks, insurance companies or large capitalization, dividend-paying equities. These types of CEFs, which include split share funds (i.e. 5Banc Split Inc., M-Split Corp., Canadian Life Companies Split Corp., etc.) and yield-oriented unit trusts (i.e. CanBanc 8 Income Fund, CC&L Canadian Banc Capital Securities Trust, CC&L Australian Banc Income Fund, etc.) would not comply with the 10% concentration restriction which currently applies to mutual funds. However, designating these CEFs as alternative funds would imply a level of riskiness or innovation which is actually not present, and subject dealing representatives who sell these CEFs to proficiency requirements which are unnecessary to ensure full understanding of the products.

3. Investments in Illiquid Assets

If the Alternative Funds Framework is adopted, we submit that it should not include any restrictions on investing in illiquid assets, to provide optimal flexibility for alternative funds (whether they are mutual funds or CEFs) to offer unique and diverse investment strategies which may involve investments in illiquid assets. Assuming that this approach to concentration is taken under the Alternative Funds Framework, we submit that CEFs which are not alternative funds be permitted to hold illiquid assets representing in the range of 25% to 30% of NAV, and that the 90 day divestiture requirement continue to apply. In our view, this is a balanced approach because it provides CEFs with greater investment flexibility in recognition that CEFs do not have the same liquidity constraints as mutual funds, while at the same time ensuring that CEFs with highly illiquid portfolios appropriately identify themselves as alternative funds.

Imposing the lower 10% threshold on CEFs which have an annual redemption feature is unnecessary, since CEFs have significant lead time ahead of their annual redemption dates in which to meet their liquidity requirements, particularly since the redemption date NAV is struck subsequent to the redemption tender date. In our view, CEF promoters and managers are capable of ensuring that the redemption features available to investors are appropriate for the liquidity profiles of their funds, and if a highly illiquid investment strategy is pursued, the CEF will be designated as an alternative fund and will be unlikely to have an annual redemption at NAV.

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4. Borrowing

We submit that investment funds should have the flexibility to borrow from non-Canadian financial institutions provided that such institutions are appropriately regulated in their home jurisdictions. In our increasingly global economy, regulatory reciprocity has become essential to maintain safe and efficient international capital markets. The CSA have embraced this new reality, as evidenced by your participation in the international efforts to regulate over-the-counter derivatives. The CSA should take a similar approach when regulating the borrowing abilities of public investment funds, by permitting them to borrow from foreign financial institutions, provided they are appropriately regulated. The CSA could rely on an international standard for the purpose of identifying which jurisdictions' financial institutions should be included, such as countries which adhere to the Third Basel Accord (Basel III).

5. Investments in Mortgages

If the Alternative Funds Framework is adopted, we submit that CEFs which identify themselves as alternative funds should be permitted to invest in non-guaranteed mortgages, to provide optimal flexibility for alternative fund CEFs to offer unique and diverse investment strategies. The naming convention, proficiency requirements and other protections proposed in the Alternative Fund Framework ensure that investors and their advisors are aware of, and capable of understanding the risks, associated with non-guaranteed mortgages and how they are addressed by the alternative fund's risk management tools.

6-7. Fund-of-Fund Structures – Forward Funds

In our view this discussion is largely academic since the federal budget announced on March 21, 2013 will effectively eliminate the future use of forward funds.

For those existing funds which have been grandfathered, we submit that the requirement for the underlying fund to be a reporting issuer in every jurisdiction where the top fund is distributed overreaches the stated regulatory objective and increases the regulatory costs of fund-of-fund structures which are borne by the top fund's investors. The passport system enshrines the "principal regulator" concept and endorses regulatory reliance amongst all CSA jurisdictions. Under this approach, it should be sufficient for the bottom fund to be a reporting issuer in its principal jurisdiction provided that its continuous disclosure is available to investors across the country, which is achieved by requiring the top fund to deliver bottom fund disclosure to all of its investors and also by filing disclosure documents on the System for Electronic Document Analysis and Retrieval (SEDAR).

8. Organizational Costs of New Non-Redeemable Investment Funds

The capital raising model followed by CEFs can support payment of all of the organizational costs out of the proceeds of the initial public offering, and the CEF industry has existed on this basis for many years. Investors anticipate that organizational costs will be borne by the CEF, and this is clearly reflected in the opening NAV of the securities of each CEF. Unlike mutual funds which often start off small and rely on seed capital from their managers, CEFs are distributed by a dealer syndicate and their offerings are not completed unless a sufficient amount of capital is raised to satisfy organizational costs and justify the ongoing costs of maintaining a stock exchange listing. By paying their organizational costs at the outset, it may be argued that CEF managers can charge lower management fees than mutual fund managers, which embed the organizational costs that they are forced to bear in their ongoing management fees and/or redemption penalties. Imposing this requirement on CEFs will likely cause CEFs to increase their management fees and introduce redemption penalties in order to cover these costs.

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The fee structure offered by Lawrence Park Tactical Credit Fund ("**Lawrence Park Fund**"), for which the preliminary prospectus was filed on June 4, 2013, exemplifies the type of fee structures we expect will become commonplace if subsection 3.3(3) of NI 81-02 is adopted. CI Investments Inc., the manager of Lawrence Park Fund (the "**Manager**") is paying all fees and expenses of its initial public offering (at $10 per unit), in compliance with subsection 3.3(3) of NI 81-02 and in contrast with most CEFs currently in the market. Lawrence Park Fund provides an annual redemption at NAV in December of each year, however, for the first seven years of its existence, redeeming unitholders are subject to a redemption fee per unit which starts at $0.525 in the first year and declines by $0.075 each year until it is eliminated. In addition, Lawrence Park Fund imposes an "Annual Redemption Condition" in the first two years which restricts the annual redemption right to circumstances where the fund has not satisfied its annual distribution target and the NAV per unit is below $10. With this fee structure, the Manager recoups all of the offering costs over time, but the reported NAV of Lawrence Park Fund is somewhat misleading for its first seven years, since a redeeming unitholder would be subject to a redemption penalty. We expect that this fee structure will be priced into the market price of Lawrence Park Fund's units quite quickly, resulting in a discounted trading price, even relative to the NAV less redemption penalty. We have already observed these types of trading discounts in respect of other CEFs with back-end load fee structures similar to Lawrence Park Fund, such as Copernican British Banks Fund, Copernican International Financial Split Corp. and Copernican World Banks Split Inc.

We expect that back-end load fee structures will become commonplace for CEFs if subsection 3.3(3) of NI 81-02 is adopted, which will arguably result in misleading NAVs, trading discounts and no real benefit to investors. We recommend that CEFs be permitted to continue to bear their offering costs as they have done for many years, since their initial offering sizes provide sufficient capital to do so.

9. Dilutive Issuances of Securities

We submit that the prohibitions on: (i) issuances of warrants, rights and specified derivatives set out in Section 9.1.1; and (ii) dilutive offerings set out in subsections 9.3(2) and (3) of the NI 81-102 amendments in the CSA Proposal (for simplicity, these types of offerings are collectively referred to as "**Warrant Offerings**") impose undue restrictions on CEFs. We recognize the CSA's regulatory objective in proposing these provisions, as stated in the CSA Proposal:

> As warrants are automatically issued to securityholders, warrants may also appear to be coercive, with securityholders obligated to make an additional investment or face the risk of dilution... [I]nvestors in non-redeemable investment funds may not expect the costs of warrant issuances to be part of their investment bargain; specifically, investors do not generally expect that the fund they invest in will seek additional capital from them after they have made the initial investment, or that they will have to incur costs for the fund to raise additional capital.

We propose that CEF issuers who expect, or would like the flexibility, to issue warrants after their initial public offerings should disclose this expectation or possibility in the CEF prospectus, including providing conditions under which warrants may be issued (i.e. timeline, total NAV of the CEF and/or NAV per security, volume weighted market price over a particular period leading up to the warrant offering). This disclosure will address the CSA's concern that investors may not expect the risk of dilution and/or the CEF requesting an additional investment, while at the same time preserving the ability for CEFs to complete Warrant Offerings. Warrant Offerings are beneficial for CEFs and their investors because they give smaller CEFs, whose size has been reduced by annual redemptions or otherwise, the ability to raise additional assets. These new assets should lower the CEF's management expense ratio to the benefit of all investors.

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B Specific Questions of the CSA Relating to the Alternative Funds Framework in NI 81-104

1. Definition of "Alternative Fund"

In our view, the term "alternative fund" appropriately describes the types of investment funds that should be captured in NI 81-104. By proposing the Alternative Funds Framework, the CSA is proposing to give retail investors access to alternative asset classes, subject to regulatory safeguards such as the naming convention, adequate disclosure and proficiency. This is a positive development for the Canadian capital markets, and should be used to maximize the range of investment options available.

2. Concentration Restriction

We submit that the Alternative Funds Framework should not include any concentration limit, to provide optimal flexibility for alternative funds (whether they are mutual funds or CEFs) to offer unique and diverse investment strategies which may involve highly concentrated investments. Today, CEFs commonly referred to as "split shares" sometimes invest in the securities of only one issuer (albeit a highly liquid, low volatility issuer) and, if they are subject to NI 81-102, such split shares are required to obtain exemptive relief from the CSA to engage in a conservative investment strategy which provides income streaming benefits to investors. Examples include BNS Split Corp. II and M-Split Corp., which respectively hold securities of Bank of Nova Scotia and Manulife Financial. Another category of CEFs which use highly concentrated investment strategies are precious metal funds such as the Sprott Physical Bullion Trusts (Sprott Phyiscal Gold Trust, Sprott Physical Silver Trust and Sprott Physical Platinum & Palladium Trust) and the Royal Canadian Mint's Canadian Gold Reserves Echange Traded Receipts. These are two examples of innovative investment strategies that would not be permitted under any sort of concentration restriction.

Rather than asking for other examples of concentrated investment strategies in which alternative funds should have flexibility to engage, we recommend that the CSA give as much scope as possible for alternative funds to innovate without being hampered by a concentration restriction. In our view, the naming convention, disclosure and proficiency requirements set out in the Alternative Funds Framework will ensure that investors and their advisors are aware of, and capable of understanding the risks, associated with concentrated investment strategies.

3. Issuer Concentration calculated based on Notional Value

We reiterate our submission that the Alternative Funds Framework should not include any concentration limit, to provide optimal flexibility for alternative funds (whether they are mutual funds or CEFs) to offer unique and diverse investment strategies which may involve highly concentrated investments. However, if the CSA determine that some concentration restriction is necessary for alternative funds, we agree with the suggestion that issuer concentration be based on total notional exposure of the fund, given that alternative funds will be permitted to have more leveraged exposure.

4. No comment

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5. Short Selling

We submit that NI 81-104 should include exemptions from subsections 2.6.1(2) and (3) of NI 81-102 to permit the creation of leverage through borrowing and increase flexibility for alternative funds to engage in long/short strategies. Many “classic” hedge fund strategies have a long-short component, such as long-short equity, convertible arbitrage, merger arbitrage and others. If the Alternative Funds Framework seeks to provide retail investors with appropriately safeguarded access to alternative strategies, providing alternative funds with the ability to engage in short selling is essential. Market-based restrictions on short selling under the marketplace operation rules and Universal Market Integrity Rules (i.e. prohibitions on “naked” short sales, dealer maintenance of “hard to borrow” lists, three day settlement discipline) provide adequate protections to ensure that alternative funds do not engage in unduly risky or reckless short selling.

8-9. Total Leverage Limit

We agree that alternative funds should be subject to a total leverage limit, whether it is 3x as proposed by the CSA or slightly higher, i.e. 4x. This will provide a baseline of protection for retail investors from highly levered products that are not appropriate even under the Alternative Funds Framework. We do not believe that mutual funds which are alternative funds should face a different leverage limit from CEFs due to the requirement to fund redemptions. In our view, alternative fund sponsors and managers are in the best position to manage the liquidity requirements of their products, and would not offer a mutual fund which could not satisfy daily redemption requests.

We recommend that the CSA take a flexible approach toward the definition of leverage which allows alternative funds to calculate leverage in accordance with industry standards applicable to their strategy. For example, a long-short equity strategy typically calculates leverage by dividing the sum of total long and total short positions by NAV, while a convertible arbitrage strategy typically calculates leverage by dividing the sum of total long positions only by NAV.

10. Other Investment Restrictions for Alternative Funds

In our view the Alternative Funds Framework should be as permissive as possible, and should not explicitly permit or prohibit any strategy. This will provide the greatest opportunity for Canadian fund sponsors, managers and portfolio advisors to develop and market innovative investment strategies and products.

11. On-going Investment by Sponsors

The sponsors of an alternative fund should be permitted to withdraw their seed capital investment if the fund reaches a sufficient size. We believe that the requirement for seed capital to remain in the fund is based on the regulatory objective of aligning the financial interests of a fund’s sponsors with its securityholders. However, other mechanisms such as management fees and performance fees, which are customary in the alternative fund industry, may achieve the same objectives without unnecessarily tying up the sponsor’s capital, which could then be used to develop other products.

12. Proficiency

In our view, the proposal to impose additional proficiency requirements on individual dealing representatives who sell securities of alternative funds is fundamental to the success of the Alternative Funds Framework. We believe that many of the “scandals” which the retail investment fund industry

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has experienced in the past decade (i.e. Portus Asset Management Inc., Sextant Capital Management Inc., Asset Backed Commercial Paper derived products, etc.) may have been avoided if individual dealer representatives properly understood the risks of their products and effectively discharged their suitability obligations. We submit that individual dealer representatives who sell securities of alternative funds be subject to similar proficiency requirements as advising representatives under National Instrument 31-103 *Registration Requirements* (NI 31-103), i.e. such representatives should have the Chartered Financial Analyst designation or the Canadian Investment Manager designation, plus the respective years of experience. The CSA may also consider the Chartered Alternative Investment Analyst designation maintained by the Chartered Alternative Investment Analyst Association as an appropriate proficiency designation for individual dealer representatives who sell securities of alternative funds, also complemented by a number of years of alternative investment management experience.

We submit that there should also be a category of individual alternative fund dealer representatives subject to proficiency requirements similar to those applicable to associate advising representatives under NI 31-103, to enable junior representatives to be trained in the alternative funds area and make sales under appropriate supervision.

13. Naming Convention

In our view, requiring all alternative funds to self identify will be an effective tool for distinguishing such funds for investors and the market. It is not necessary for conventional mutual funds to include the word “conventional” in their names, as the lack of the word “alternative” is sufficient for this purpose.

14. Monthly Website Disclosure

We endorse the CSA’s proposal for alternative funds to include disclosure regarding their largest monthly NAV drawdown in the past five years and the maximum and average daily leverage employed during the most recent twelve month period. It may also be useful for alternative funds to provide other relevant metrics which they use on an ongoing basis to monitor portfolio risk, which will vary between funds and strategies. However, we suggest that a monthly requirement to provide this disclosure may be unduly onerous and costly, and a quarterly requirement would be more suitable.

C. Public Disclosure of Annual Redemption Process

Periscope Capital recommends that closed end funds which offer annual redemptions at NAV (including conventional CEFs and alternative fund CEFs) be required to publicly disclose details of their annual redemption process via press release, including the following information:

- number of securities tendered for annual redemption;
- in cases where the annual redemption right is limited to a percentage of NAV, the number of securities taken up for annual redemption[1];
- NAV applicable on the redemption date (this information is already publicized on the web sites of most CEF managers within a reasonable period after NAV calculation);

[1] For example, Enervest Diversified Income Fund offers annual redemption at 95% of NAV (less expenses incurred to fund the redemption) for up to 10% of the units outstanding on the redemption date. Similarly, Citadel Income Fund and Energy Income Fund offer offer annual redemptions at 100% of NAV (less expenses incurred to fund the redemption) for up to 10% of the units outstanding on the redemption date.

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- Actual amount of redemption proceeds payable to the investor after redemption costs, charges and other deductions ("**Redemption Proceeds**");
- redemption charges deducted from NAV in order to calculate the Redemption Proceeds;
- redemption penalties deducted from NAV in order to calculate the Redemption Proceeds (such as the back-end load fees charged by CEFs like Lawrence Park Fund described in our response in Section A, Question 8 above); and
- any other relevant matters which affected the calculation and/or payment of Redemption Proceeds.

Currently, disclosure in the prospectuses of most CEFs 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 CEFs 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 differ between fund managers, sometimes materially. When deciding whether to invest in a particular CEF, 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 amount of Redemption Proceeds paid, when compared to the NAV per security as of the date of redemption. This disclosure will be even more valuable if the CSA prohibit CEFs from paying their organizational costs as discussed in Section A, Question 8 above, which we expect will result in more complicated fee structures, redemption penalties and other charges.

IV. CONCLUSION

Thank you for providing us with this opportunity to comment on the CSA Proposal. We would be pleased to provide further detail regarding our comments upon request from the CSA.

Best Regards,

"Lori Stein"

Lori Stein
General Counsel & Chief Compliance Officer

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