July 12, 2013

BY ELECTRONIC MAIL: jstevenson@osc.gov.on.ca**,** consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Attention:

Anne-Marie Beaudoin, Corporate Secretary
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The Secretary
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Dear Sirs and Mesdames:

RE: Proposed Amendments to Multilateral Instrument 62-104 *Take-Over Bids and Issuer Bids*, National Policy 62-203 *Take-Over Bids and Issuer Bids* and National Instrument 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues (the "Proposals")

We are writing to provide comments on behalf of the Members of The Investment Funds Institute of Canada (IFIC) with respect to the Proposals.

We acknowledge and support the overall objectives of the early warning system in Canada - to protect the markets by predicting possible take-over bids and similar control activity[1], and the objectives of the Proposals - to respond to increasing shareholder activism and to anticipate proxy-related matters where a 5% threshold may be critical.

We agree that transparency in the capital markets, about activity by investors who are acquiring large quantities of securities with the intention of exercising control over an issuer, is essential. As significant participants in the buy side of the market, investment funds are equally interested in having as much real-time information about such activity as possible, as it may bear on their assessment whether to buy and/or continue to hold the securities of issuers who are the subject of such activity.

[1] In its 1998 Proposed NI 62-103, the CSA noted "The early warning system contained in the securities legislation of most jurisdictions requires disclosure of holdings of securities that exceed certain prescribed thresholds in order to ensure that the market is advised of accumulations of significant blocks of securities that may influence control of a reporting issuer. Dissemination of this information is important because the securities acquired can be voted or sold, and the accumulation of the securities may signal that a take-over bid for the issuer is imminent. In addition, accumulations may be material information to the market even when not made to change or influence control of the issuer. Significant accumulations of securities may affect investment decisions as they may effectively reduce the public float, which limits liquidity and may increase price volatility of the stock. Market participants also may be concerned about who has the ability to vote significant blocks as these can affect the outcome of control transactions, the constitution of the issuer's board of directors and the approval of significant proposals or transactions. The mere identity and presence of an institutional shareholder may be material to some investors."

However, we believe that the Proposals in their current form may actually reduce the transparency in the system as they will generate significantly increased volumes of real-time transaction reporting from entities that are not and cannot be active investors and for whom alternative monthly reporting might be more appropriate. This increase in volume of information from both active and passive investors will add significant amounts of superfluous information ("noise") to the system, making it more difficult to identify and focus on the valuable information that identifies actual take-over and insider activities as the rules intend.

We offer several suggestions for improvements to the current regime which we believe will better meet the intended objectives, increase the amount of real-time information for cases where there is a risk of takeover activity and reduce the superfluous noise generated by the application of an across-the-board reduction in the reporting threshold.

NI 81-102 Mutual Funds Should be Eligible Institutional Investors

The CSA has acknowledged that in the early warning system there is no need to require real-time reporting from passive investors that do not intend, or that are legally unable, to exercise control over an issuer. This approach underlies the creation of the Alternative Monthly Reporting ("AMR") system for eligible institutional investors ("EIIs"), on the basis that it is sufficient for the market to be generally informed about these institutional investors' transactions, which exceed the established thresholds, and only on a monthly cycle. The inability of such investors to exercise control over an issuer, notwithstanding that they may acquire large positions, is considered a sound reason for the market to not require real-time activity reports from such investors.

As NI 81-102 mutual funds are in all respects passive investors – they are institutional in nature and unable to exercise control over issuers in which they invest - they meet the policy rationale for inclusion as EIIs and should be brought within the definition of EIIs and permitted to file monthly reports under the AMR system about the size of assets and the changes in assets.

Reviewing the history of the AMR, we note that monthly reporting was considered sufficient to ensure large holding and institutional investor information, even from passive investors, is available to the market to keep the public informed. Even though NI 81-102 mutual funds are not, by virtue of section 2.2, permitted to hold securities representing more than 10% of the votes or outstanding securities of an issuer, nor permitted to purchase a security for the purpose of exercising control over or management of the issuer, mutual funds that are reporting issuers were not included within the scope of EIIs during the initial implementation of NI 62-103. There can be no doubt that NI 81-102 funds are not in the business of controlling or making takeover bids of issuers.

In comments responding to the September 4, 1998 consultation draft of NI 62-103, a number of industry respondents suggested that mutual funds that are reporting issuers should be considered EIIs and therefore be allowed to benefit from the AMR system. The CSA's response[2] reiterated that such funds are not included in the definition of EII but provided no reasoning for this position, other than stating a conclusion based on circular logic that to consider such funds to be EIIs is unnecessary since they are not permitted to acquire more than 10% of the outstanding shares of an issuer, and if the fund should receive exemptive relief to permit the acquisition of more than 10% of an issuer's shares, the relief could deal with compliance with the early warning notification requirements. The conclusion also appeared to be based on an assumption that the portfolio managers of such mutual funds, since they qualify as EIIs, would file the AMR reports for all of the funds they manage. This may have been a legitimate practical result when the control threshold in NI 81-102 and the reporting threshold in NI 62-103 were the same (although it neglected to consider the implications for mutual funds that held convertible securities). The Proposals, however, now seek to lower the reporting

[2] The CSA noted that "the inability of mutual funds to disaggregate in their own right should not cause problems in the ordinary course. Public mutual funds are prevented by securities legislation from taking positions in excess of 10 percent of the outstanding voting or equity securities of an issuer, and so should not generally be in a position to be subject to the early warning requirements or the insider reporting requirements. If a mutual fund does receive approval to exceed 10 percent, the terms of the approval could be structured to provide appropriate relief from those requirements."

threshold to the point where mutual funds will frequently be subject to early warning reporting obligations.

There is no rationale to subject NI 81-102 funds to a higher level of reporting than other passive institutional investors, particularly since higher compliance costs will ultimately be borne by retail investors.

NI 81-102 mutual funds should be completely exempted from the reporting requirements since compliance with those requirements is, for practical purposes, left to their managers. As long as funds are obligated to file, the reduced threshold for early warning reporting will significantly increase the number of required filings and therefore will simply add noise into the system. This noise will be exacerbated by the provisions in the Proposal that require inclusion of warrants and convertible securities. Since it is already well known in the market that institutional investors are known to own large amounts of securities, we see no transparency benefit in requiring the generation of this additional noise.

Mutual funds must continuously rebalance their portfolios in order to stay aligned with their investment objectives, especially if they are index funds. This portfolio adjustment activity means that mutual funds will trigger the reporting threshold, whether it is 5% or 10%, on a regular basis. In addition, because of the Proposal to require reporting when there are changes in holdings of 2% or more, funds' portfolio rebalancing activity will cause an increase in reporting of changes, both increases and decreases, which floods the market with even more irrelevant information.

What is more, in addition to including warrants and other convertible securities as under the current rules, the Proposals also include equity linked derivatives in the calculation. Although mutual funds only acquire these types of securities in order to obtain the economic interest, the Proposal will increase the possibility of funds, as early warning reporters, exceeding the 10% reporting threshold without even exceeding the 10% control threshold. Again this generates additional filings of extraneous information. The creation of such noise is to be avoided to ensure that only relevant information is provided to the market in real time.

The exclusion of NI 81-102 funds from being EIIs not only subjects them to early warning reporting, but it also triggers insider reporting obligations for such funds. These obligations require the aggregation of holdings of all funds managed by the same manager (the acquiror). Individual fund insider reporting would serve only to add more superfluous information to the market. However, if the acquiror is an EII, it can report on the funds on a monthly basis under AMR and would be exempt from the insider reporting obligations. Since indirect reporting of funds' holdings can already be made by their EII managers, there does not appear to be any policy basis for continuing to exclude funds from being EIIs.

Furthermore, including funds as EIIs is not inconsistent with the rationale for including other passive institutional investors, nor does it pose a risk to the objectives of the regime. Given the passive nature of their investments, the real information the market needs about funds' investment activity can be adequately provided in monthly reports under AMR – there is no purpose in providing this information in real-time. Furthermore, the main safeguard in section 4.2 of NI 62-13, further enhanced in the Proposals, would disqualify an EII with respect to an issuer, if it or a joint actor proposes a shareholder or corporate action or solicits specified proxies in relation to that issuer. Even though NI 81-102 funds cannot do so, if they were to attempt such an action or solicitation they would be disqualified as EIIs automatically.

Therefore we would recommend that NI 81-102 funds and their managers both be included as EIIs, and that funds and managers be allowed to choose in each case either whether the managers will report on behalf of all of their funds, or whether the individual funds would report, but not both, but that in all cases manager/fund filings would be monthly under AMR. We believe this provides the appropriate relevant information to the market in the appropriate frequency.

NI 81-102 Mutual Funds Should be Exempt from all Early Warning Reporting

The question of whether NI 81-102 mutual funds should be included as EIIs aside, we believe there is no added transparency achieved by requiring such funds to file early warning reports individually, in any case. For the reasons stated, we propose that, in the alternative, NI 81-102 funds be exempted from the early warning and insider reporting regimes entirely, such that all of their reporting be conducted in aggregate fashion through their managers, under the AMR applying a 10% threshold. The objectives of the regime with respect to passive investors - that the market be informed of large holdings and transactions by institutional investors on a monthly rather than on a real-time basis - apply equally to public mutual funds, and would further avoid the production of excessive and irrelevant information into the market.

To repeat, as institutional investors of large portfolios of securities, mutual funds do engage in a large number of sizable securities transactions. However for NI 81-102 funds, those transactions are all for the sole purpose of generating market exposure in accordance with the investment objectives of each fund. Absent exemptive relief, mutual funds are, and will continue to be, prohibited from acquiring more than 10% of the outstanding shares of an issuer under NI 81-102.

We believe that the Proposal to reduce the reporting threshold makes now the appropriate time to exempt public funds from this requirement, if the CSA is not prepared to include them as EIIs. As described earlier, the volumes of additional reporting that will be required to be made by funds with a reduction in the threshold to 5% would not provide any benefit to the market.

We are also concerned about the effect of the Proposal to expand the information to be included in the reporting form (62-103 F1), including the investor's intention with respect to its transaction in the security. Every such report from an NI 81-102 mutual fund will declare the funds' intent in engaging in the reported transactions to be nothing more than to invest the funds' assets to obtain exposure to the market, in accordance with their investment objectives, and not to initiate a takeover bid. This does not provide any additional useful information to the market and only reduces the transparency of information in the market.

Thus, we believe the CSA should now expressly exempt NI 81-102 mutual funds that are reporting issuers from the early warning filing requirements, or expressly include them within the definition of EIIs, in either case to allow them to avail themselves of monthly reporting if they exceed the established reporting thresholds, and thereby providing the appropriate information to the market at the appropriate time.

The reporting threshold for all passive investors, including Mutual Funds, should remain at 10%

On the broader theme of the acknowledged purpose of different treatment between active and passive investors, we believe it is appropriate for the CSA to implement separate reporting thresholds for passive investors and for active investors.

As shareholders valuing real-time information on active traders, our Members agree with the proposal to reduce the reporting threshold to 5% for active investors, as this is completely consistent with the need for the market to obtain better real-time information about transactions engaged in by investors who may be accumulating a position in a target firm for a future take over.

We believe however that the reporting threshold for passive investors, in relation to which the CSA has acknowledged it is sufficient to report monthly, and the reporting threshold for NI 81-102 mutual funds, whether they are included as EIIs or otherwise permitted to apply less frequent reporting as do EIIs, should remain at 10%.

This is appropriate because these types of investors can never act with the intention of acquiring control of the issuer, and for such investors the holding/concentration limit will likely always remain at 10%. We do not believe maintaining the 10% threshold for passive investors deviates from or weakens the objective of providing the information that the market needs about such large investors. This level of AMR reporting has proven sufficient for purposes of putting that information into the market. We do not see that objective being any better served by lowering the threshold for passive investors. The rationale provided in the Proposals for lowering the threshold - to respond to the reality of increasing shareholder activism and the ability of a shareholder holding 5% to requisition a shareholders' meeting - does not apply to NI 81-102 mutual funds, just as it does not apply to other passive investors that the CSA has deemed to be EIIs. Hence, this objective is neither relevant nor would it be prejudiced in any way by allowing passive funds to continue to report on a monthly basis applying a 10% threshold.

We believe that requiring reporting from passive investors at 5% will only increase the volumes of reports (even more so if funds are also required to report individually and in real-time), and this will bury the data that is most critical for the market to have on a timely basis about active investors. The additional noise will make this information harder to find and potentially less useful to the markets, as well as potentially misinforming the market about what the changes in the portfolios of these passive investors may mean.

Our Members have observed that, even today, every filing of an early warning report can sometimes cause a sudden short-term market movement in the shares of the issuer whose securities were named in the report. Even with the current volume of reports, this can represent a large number of market activities driven off of the reports. It can be expected that the increase in such reports due to a 5% threshold could generate even more activity, from active investors and an entirely new volume of reports from mutual funds that have never had to file before. But the threshold reduction is not the only proposed change that could generate much more noise. The proposed inclusion of warrants and convertible securities in the investors' calculations and the proposed change regarding equity-linked derivatives will further increase the likelihood that mutual funds will often exceed the 5% reporting threshold even though they would not exceed the control threshold.

We are concerned that the current volatility of activity that already exists in the market will be magnified unless the additional reporting is limited only to active investors whose activity is the most important for the market to be aware of in real time.

For the many reasons stated, we believe the objectives behind the Proposals can best be served by limiting the threshold reduction to active investors.

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We thank you for allowing us to provide the views of our Members in response to the Proposals. In the attached Appendix we provide responses to the specific questions raised by the CSA in relation to the Proposal. Please feel free to contact me by email at rhensel@ific.ca or by phone at 416-309-2314 if you have any questions or if you would like to discuss our comments in more detail.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Ralf Hensel
General Counsel, Corporate Secretary, Director of Policy (Fund Manager Issues)

Enclosure: Appendix - Responses to the Specific Questions Posed in the Proposal

APPENDIX

Responses to the Specific Questions Posed in the Proposal:

Q1: Do you agree with our proposal to maintain the requirement for further reporting at 2% or should we require further reporting at 1%? Please explain why or why not.

We believe that the threshold should be kept at 2% based on the same argument that the increased volume of reporting increases the noise in the market. It is clearly important to obtain such information for active investors, however mutual funds are not permitted to be active and must remain passive.

Q2: A person cannot acquire further securities for a period beginning at the date of acquisition until one business day after the filing of the report. This trading moratorium is not applicable to acquisitions that result in the person acquiring beneficial ownership of, or control or direction over, 20% or more of the voting or equity securities on the basis that the take-over bid provisions are applicable at the 20% level. The proposed decrease to the early warning reporting threshold would result in the moratorium applying at the 5% ownership threshold. We believe that the purpose of the moratorium is still valid at the 5% level because the market should be alerted of the acquisition before the acquiror is permitted to make additional purchases.

(a) Do you agree with our proposal to apply the moratorium provisions at the 5% level or do you believe that the moratorium should not be applicable between the 5% and 10% ownership levels? Please explain your views.

(b) The moratorium provisions apply to acquisitions of "equity equivalent derivatives". Do you agree with this approach? Please explain why or why not.

(c) Do you think that a moratorium is effective? Is the exception at the 20% threshold justified? Please explain why or why not.

We believe that none of (a), (b) or (c) should apply.

Q3: We currently recognize that accelerated reporting is necessary if securities are acquired during a take-over bid by requiring a news release at the 5% threshold to be filed before the opening of trading on the next business day. With the Proposed Amendments to the early warning reporting threshold, we do not propose to further accelerate early warning reporting during a take-over bid.

(a) Do you agree? Please explain why or why not.

(b) If you disagree, how should we accelerate reporting of transactions during a take-over bid? Should we decrease the threshold for reporting changes from 2% to 1%? Or do you think that requiring early warning reporting at the 3% level is a more appropriate manner to accelerate disclosure? Please explain your views.

We agree.

Q4: The Proposed Amendments would apply to all acquirors including EIIs.

(a) Should the proposed early warning threshold of 5% apply to EIIs reporting under the AMR system provided in Part 4 of NI 62-103? Please explain why or why not.

(b) Please describe any significant burden for these investors or potential benefits for our capital markets if we require EIIs to report at the 5% level.

For the reasons stated in our submission, we believe the proposed early warning threshold of 5% should apply only to active investors, and not to EIIs or NI 81-102 mutual funds, which must remain passive in their investment activities.

Q5: Mutual funds that are reporting issuers are not EIIs as defined in NI 62-103 and are therefore subject to the general early warning requirements in MI 62-104. Are there any significant benefits to our capital markets in requiring mutual funds to comply with early warning requirements at the proposed threshold of 5% or does the burden of reporting at 5% outweigh the potential benefits? Please explain why or why not.

For the reasons stated in our submission, we believe that NI 81-102 mutual funds should qualify as EIIs, or in any event should be permitted to apply AMR reporting, since they are not permitted to exercise control over issuers, and therefore there is no market need for immediate transaction information about mutual funds' investments.

Q6: As explained above, we propose to amend the calculation of the threshold for filing early warning reports so that an investor would need to include within the early warning calculation certain equity derivative positions that are substantially equivalent in economic terms to conventional equity holdings. These provisions would only capture derivatives that substantially replicate the economic consequences of ownership and would not capture partial-exposure instruments (e.g., options and collars that provide the investor with only limited exposure to the reference securities). Do you agree with this approach? If not, how should we deal with partial-exposure instruments?

Mutual funds purposely acquire derivatives so as not to have to own securities yet still get the benefit of their economic performance. Therefore we do not agree with question six – what is the purpose of capturing this information if funds do not receive and cannot use the shareholder benefits? The purpose of informing the market about shareholder control does not apply to derivatives.

Q7: We propose changes to NP 62-103 in relation to the definition of equity equivalent derivative to explain when we would consider a derivative to substantially replicate the economic consequences of ownership of the reference securities. Do you agree with the approach we propose?

Same response as for Question 6. It is not clear if the definition of "equity equivalent" includes derivatives. In derivatives, when we speak of an equity equivalent derivative, an investor is looking to obtain an economic interest, and not to obtain any interest in the shareholder's rights. If the holder cannot vote, influence or call a shareholder meeting, and is simply holding the security for the economic benefits, why would that interest need to be included in the calculation?

Q8: Do you agree with the proposed disqualification from the AMR system for an EII who solicits or intends to solicit proxies from security holders on matters relating to the election of directors of the reporting issuer or to a reorganization or similar corporate action involving the securities of the reporting issuer? Are these the appropriate circumstances to disqualify an EII? Please explain, or if you disagree, please suggest alternative circumstances.

this does not create any real concerns.

We agree that the proposed disqualifications from the AMR system (any EII that solicits or intends to solicit proxies from security holders on matters relating to the election of directors of the reporting issuer or to a reorganization or similar corporate action involving the securities of the reporting issuer) are appropriate.

Q9: We propose to exempt from early warning requirements acquirors that are lenders in securities lending arrangements and that meet certain conditions. Do you agree with this proposal? Please explain why or why not.

This exemption seems sensible in theory, but it will truly depend on the details of each securities lending arrangement, as such arrangements are typically not uniform or consistent.

Q10: Do you agree with the proposed definition of "specified securities lending arrangement"? If not, what changes would you suggest?

Q11: We are not proposing at this time an exemption for persons that borrow securities under securities lending arrangements as we believe securities borrowing may give rise to empty voting situations for which disclosure should be prescribed under our early warning disclosure regime. Do you agree with this view? If not, why not?

With respect to questions 10 and 11, we have noted that not all securities lending arrangements are the same. In this context, each arrangement needs to be considered as to whether voting rights flow to the manager. In the US, the comparable rule on whether securities lending arrangements are to be counted, considers whether beneficial ownership flows with the borrowed securities (i.e., who holds the beneficial ownership). Nevertheless the US rule could be improved if it contained a carve-out for investment funds. In addition, the securities market in Canada is substantially smaller than that in the US.

Q12: Do the proposed changes to the early warning framework adequately address transparency concerns over securities lending transactions? If not, what other amendments should be made to address these concerns?

We have no suggestions at this time, other than that the framework regarding securities lending must respect the unique attributes of each lending arrangement, as noted in our response to Question 9, given these arrangements are typically not uniform or consistent.

Q13: Do you agree with our proposal to apply the Proposed Amendments to all reporting issuers including venture issuers? Please explain why or why not. Do you think that only some and not all of the Proposed Amendments should apply to venture issuers? If so, which ones and why?

We believe it is sensible to apply the Proposed Amendments to all reporting issuers only if the appropriate reporting threshold is maintained for each issuer type, to avoid significant increases in extraneous information in the market which reduces the transparency that the Proposals are intended to create. With respect to venture issuers, we suggest the threshold for such interests should be left at 10%. To do otherwise would produce, in the mining area particularly, multiplicity of requirements.

Q14: Some parties to equity equivalent derivatives may have acquired such derivatives for reasons other than acquiring the referenced securities at a future date. For example, some parties to these derivatives may wish to maintain solely an economic equivalency to the securities without acquiring the referenced securities for tax purposes or other reasons. Would the proposed requirement lead to over-reporting of total return swaps and other equity equivalent derivatives? Or would the possible over-reporting be mitigated by the fact that it is likely that parties to equity equivalent derivatives would qualify under the AMR regime?

Over-reporting will occur as a result of and required reporting on derivatives. When mutual funds acquire such derivatives there is no intent to own the underlying securities. Therefore it seems inappropriate and misleading to suggest to the market that a fund owns a certain amount in the derivative when the derivative is held only for economic exposure. We do not understand how the market is enhanced or better informed by knowing that.

Q15: If the proposed new requirement does lead to an over-reporting of these derivatives, is this rectified by the requirement in the early warning report for acquirors to explain the purpose of their acquisition and thereby clarify that they do not intend to acquire the referenced securities upon termination of the swap?

We submit that almost no one reads all of the information in the Early Warning Reports – they look to the name of the entity that is reporting and the size of the transaction that is being reported. The volume of reports from passive investors puts too much extraneous information into the system and that, in turn, creates inappropriate investor reaction. The markets are already over-reactive. The net result will be to create market effect that is not useful and is potentially troublesome, as it will amplify already reactive behaviours.