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Delivered By Email: comments@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
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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs and Mesdames:

RE: CSA Notice and Request for Comments

We are writing on behalf of BMO Capital Markets, CIBC, National Bank Financial, RBC Capital Markets, Scotiabank and TD Securities. As noted below, comments have been coordinated in an effort to engage in discussions with CSA Staff with a view to clarifying, narrowing and resolving issues that have been raised in the CSA Notice and Request for Comment published on March 27, 2013 (the "**Notice**") concerning Phase 2 of the CSA's modernization project (the "**Modernization Project**"). They (referred to herein as "we") support this initiative and believe that a periodic review of regulation can contribute to market efficiency and enhance investor protection. We appreciate the opportunity to comment on the Modernization Project.

We also refer to CSA Staff Notice 11-324 published on June 25, 2013 (the "**Extension Notice**"), in which the CSA extended the comment period in respect of the Notice until August 23, 2013 and clarified the specific proposed amendments to NI 81-102 in respect of which immediate comment was being requested, noting that the other proposals (involving the redesign of NI 81-104 to create a more comprehensive framework for "alternative funds") would be considered at a

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later time. Accordingly, we have restricted our comments to the issues specifically noted in the Extension Notice and look forward to working with CSA Staff as they develop the Alternative Funds Framework.

As noted below, in subsequent discussions with certain CSA Staff (representatives of the Autorité des marchés financiers and the Ontario Securities Commission), we believe we have reached consensus on several of the proposals in respect of which the Extension Notice sought immediate comment. Accordingly, we thought it would be most helpful at this stage to provide the CSA with background information, by way of context for considering policy reform, and then focus on those proposals highlighted in the Extension Notice in respect of which we continue to have concern. With respect to such proposals (i.e., certain investment restrictions, fund-of-fund structures and organizational costs), we are strongly of the view that it is difficult to comment definitively without a better understanding of the Alternative Funds Proposal and whether such framework would provide a viable framework for a closed end funds ("**CEFs**") structure. While we recognize the CSA has spent considerable time and effort on the proposed amendments to NI 81-102, we believe that reform of the regulatory framework for CEFs would benefit from a more holistic approach. We believe that the CSA should defer consideration of these proposals as well as certain other detailed requirements proposed in the Notice that were not raised in Staff Notice NI 81-322, and address them in the context of the proposed Alternative Fund Framework.

I. General Comments

Staff Notice 81-322 (issued in May 2011) indicated the CSA's intention to impose "certain core restrictions and operational requirements" on CEFs to promote investor protection. Those identified in the Staff Notice were:

- conflicts of interest provisions;
- securityholder and regulatory approval requirements (for fundamental changes); and
- custodianship requirements.

We support the reforms proposed in the Notice in respect of each of these issues.

The proposed amendments to NI 81-102 contained in the Notice are highly detailed. Many, however, extend beyond the issues that were identified two years ago in Staff Notice 81-322. If enacted in their proposed form, we believe they could have a significant negative impact on an industry that we believe is functioning well under the current regulatory regime and on best practices that have been developed by investment dealers and other industry participants.

The underlying thrust of the Notice appears to be to more closely align the regulatory framework for CEFs with the regulatory framework that governs mutual funds. The stated purposes for doing so include "fairness" and to "level the playing field".

This approach may be appropriate with respect to the core operational requirements (the "**Core Operational Requirements**") noted in Section III below, in respect of which the regulatory objectives are common across all retail investment fund products. We are not aware of analysis (evidence-based, cost-benefit or regulatory impact) that indicates the other proposed amendments would advance either of these objectives or that of investor protection generally.

Fitting CEFs into the mutual fund regulatory framework effectively disregards the purposeful and legitimate reasons for which different regulatory environments have evolved over time. We believe that doing so risks unwarranted regulatory rigidity (thereby increasing pressure on the CSA for exemptive relief) and, more notably, would reduce investor choice, product innovation and capital raising.

The Notice does not define "fairness" nor does it explain how the proposals would serve that objective. In terms of creating a "level playing field", we note that CEFs are already subject to distinct (and, in some respects, more onerous) regulatory requirements designed to reflect the unique attributes of the asset class, and the reasons for which those requirements have been imposed.

We believe that the proposed changes to the CEF regulatory framework with respect to investment restrictions and organizational costs would benefit from consultation with a wide array of industry participants.[1] Over the course of several meetings with CSA Staff last month, representatives of the undersigned institutions welcomed the opportunity to have a frank and constructive dialogue with CSA representatives. We believe that consultation with other industry participants (including dealers, investment fund managers, portfolio managers, investors and their advisors) would aid the CSA in achieving its objectives. This would provide the CSA a more nuanced understanding of the CEF market and perhaps lead to a better informed perspective on the regulatory issues to be addressed (and appropriate responses thereto).

In the interim, the CSA should clarify its intention as soon as possible to grandfather existing CEFs in respect of any substantive changes to investment restrictions that may be imposed in the future. Likewise, we submit that to the extent that any substantive changes in the investment restrictions would alter the nature of existing products that investors have chosen to invest in, their property rights must be fully protected by a grandfathering provision.

II. Industry Background

Before providing specific comments, we thought it would be helpful to offer some context, both as to the nature of the CEF industry and with respect to regulatory objectives and processes.

CEFs have been an important part of the Canadian public market for several decades and have maintained an aggregate market capitalization of approximately $30 billion in recent years. Recently CEFs have come to represent approximately 10-15% of all new equity issuances in Canada and approximately 70% of all new listings on the Toronto Stock Exchange (the "**TSX**"). CEFs were never intended to replicate open end mutual funds. Rather, they are designed to provide investors with investment options not available in a traditional NI 81-102 mutual fund. CEFs provide retail investors with important investment options, many of which were innovated in the CEF market, that may include:

- monthly or quarterly cash distributions;
- professional management in sectors that are under-represented by the mutual fund industry;
- access to strategies designed to mitigate volatility and protect capital that are not available in the mutual fund industry and not easily implemented by brokers for individual clients;

[1] A recent example of robust consultative process would be that adopted with respect to mutual fund fees – starting with the publication of a Discussion Paper and then an open roundtable discussion, prior to the publication of proposed regulation.

- access to Canadian and international portfolio managers who may not be accessible to retail investors via mutual funds or ETFs;
- access to asset classes or investment strategies more commonly invested in only by institutional managers; and
- TSX listing and liquidity – providing investors with the ability to sell their funds through the secondary market.

CEFs have also become an important capital raising mechanism for issuers or industries which may have constraints on their ability to raise capital on attractive terms. For instance, flow through funds are an important source of capital for Canadian junior mining and oil and gas issuers.

The Market is Working Well

The undersigned share a common interest in the long term viability of this market and have adopted policies and procedures designed to serve their retail clients by ensuring that (i) the products will serve the purpose for which they have been structured and sold, (ii) there is full, true and plain disclosure, and (iii) the products are suitable for those who purchase them. All of the major investment dealers have a rigorous due diligence, risk rating and approval process through which CEF offerings are vetted by experienced market professionals with respect to disclosure, risk and suitability. We note that, in the past 24 months, virtually all CEF offerings were led by one of the six bank-owned investment dealers. CEFs must undergo an underwriting committee process before a major investment dealer firm will support a public offering. In addition to the viability of the investment strategy, specific issues such as the use of leverage, the use of derivatives and disclosure concerning the CEF's ability to pay indicated distributions are carefully scrutinized before an offering is launched.

The investment dealers through whom CEFs are distributed have developed a number of best practices[2] that are imposed upon CEFs seeking to come to market. They include the following:

- Although at law retraction rights are not required for CEFs, most CEFs offer unitholders an annual retraction right at net asset value ("**NAV**") starting 18 to 24 months after closing. This provides an important secondary source of liquidity for investors, and also supports the trading price of the CEF securities.[3]

- Issue expenses payable by the fund are capped at 1.5% of the gross proceeds of the offering (exclusive of agency fees).

- A CEF that seeks to list securities on the TSX must raise at least $20 million (to ensure minimum liquidity and economies of sale).

- Service fees paid to investment advisors (commonly referred to as trailer fees) are generally limited to 50 basis points – lower than service fees typically paid by mutual funds or for funds offered under an offering memorandum.

[2] Not all of these requirements apply to flow-through funds.
[3] Exceptions or modifications to the annual retraction privileges are generally to accommodate specific asset classes or strategies, so as not to negatively impact the portfolio manager's ability to meet the Fund's investment objectives and consequently disappoint investor expectations.

- An extensive list of investment restrictions such as caps on leverage, concentration and the use of derivatives, are carefully negotiated and generally fall within a narrow band that is determined to be appropriate to the asset class, investment strategy and manager's expertise.

- Unitholder approval requirements closely follow those required at law for mutual funds.

The investment dealers and the investment fund managers ("**IFMs**") who have prospectus liability and reputational/relationship risk for these products depend on satisfied investors. To this end the dealers have, for some time, been supervising and imposing key terms and conditions for the benefit of investors and the market. In addition to the discipline of market forces, we would note that IFMs, portfolio managers, directors and trustees are subject to fiduciary obligations (as well as market forces) and, to the extent there are concerns about conflicts of interest, appropriate safeguards apply under NI 81-107 (Independent Review Committee for Investment Funds). To the extent there are concerns that investors might be misled, a CEF prospectus is subject to extensive third party (and CSA) review. The community of participants would welcome the opportunity to work with the CSA to consider and, if deemed appropriate, enhance standards and practices.

CEFs are a Unique Type of Product

CEFs were never designed to replicate open end mutual funds. CEFs are primarily distributed through an initial public offering, are generally stock exchange listed and are primarily distributed through the full service (IIROC licensed) investment dealer channel.[4] These differences are relevant to the nature and extent of the regulation that ought to apply. For example:

- Because of the stock exchange listing, investors need not rely solely on redemption rights for liquidity. As a result, concentration restrictions and investment liquidity concerns are not the same as those that govern the regulation of mutual funds.

- CEFs are not distributed on a continuous basis They are primarily distributed via an initial public offering, which makes the process of bringing a CEF to market much more complex and expensive.

- The issuer, its promoter and the investment dealers (as agents in the offering) have statutory civil liability for prospectus disclosure.

- The simplified prospectus and annual information form requirement for a mutual fund is a much simpler document and requires no underwriter involvement and typically less legal work. Unlike mutual funds, that provide more standardized disclosure in their offering documents, a CEF offers securities under a long form prospectus that tends to be very detailed in the investment description covering issues such as investment strategy, the methodology for determining and paying distributions as well as the tax treatment of such distributions and, where applicable, the use of leverage, hedging, covered call writing and other specific strategies. The prospectus form (41-101F2) also requires disclosure of the sector(s) that the fund invests in.

[4] CEFs are also available through online brokers.

- Distribution through the investment dealer channel means extensive involvement by agents in the preparation of the prospectus with the issuer and the performance of detailed due diligence. Both the fund and the investment dealers typically engage separate external legal counsel, the fund retains an external audit firm and both the IFM and the agents commit significant internal resources in the development, due diligence and launch of a single CEF. Unlike in the case of mutual funds, it is generally not possible to include several funds in one prospectus. Accordingly, the cost to bring a CEF to market cannot be spread over several funds. In addition, mutual funds have the benefit of a continuous distribution model which allows them to continue to issue securities without the 90 day time limit imposed on a long form prospectus offering which typically provides for a minimum and maximum offering.

- The fact that CEFs are distributed through full service, IIROC supervised, dealers requires that individual investment advisors or brokers ensure the investment is suitable for their client. As was noted in the report, "Financial Product Development Standards and Practices", issued by the Joint Forum Product Disclosure and Regulation Committee on April 2, 2013:

  > "The work and processes of dealers and advisors who distribute such 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."[5]

Regulatory Objectives

The history of investment fund regulation reflects the recognition of a fundamental difference between mutual funds and CEFs and the need for greater flexibility with respect to the regulation of the latter. When National Policy No. 39 was first proposed to be replaced by NI 81-102, the CSA noted that:

> "Regulation of mutual funds by Canadian securities regulatory authorities has resulted from the primary regulatory need to ensure that the key feature of mutual funds is achieved: that is, the right of investors to redeem securities on demand … the authors of a commentary on a proposed federal mutual funds statute published in 1974 described the rationale (which is equally relevant in 1997) for mutual fund regulation of the nature provided for in NP 39 and by the proposed National Instrument, as follows: constraints in the mutual fund form of organization result largely from the availability of the right to redeem which is the key attribute of a mutual fund. This right dictates restraints to avoid investments that would result in portfolios which could not be precisely valued or would be illiquid as to make the redemption right unrealistic. … The fact that shares of most mutual funds are in the course of continuous public distribution requires special regulation of the sales function. Constraints inherent in the nature of the market to which mutual funds have historically made their greatest appeal include the necessity of rules to prevent the investor who looks on the mutual

[5] The Joint Forum, "Financial Product Development Standards and Practices" at p. 29, April 2, 2013. Available at http://www.jointforum.ca/en/init/product_dislcosure/fin_product_dev_stds.pdf

> fund as a long-term savings vehicle from being subject to the risks of an unusual or highly leveraged investment portfolio. However, if possible, the rules should be so formulated as not to prevent the organization of mutual funds with distinctive investment objectives designed to appeal to classes of investors with distinctive wishes or requirements."[6]

If and to the extent concerns have arisen that justify the elimination of this difference in approach to the regulation of mutual funds from CEFs, our belief is that disclosure of risks is the appropriate regulatory instrument. This serves the interests of investor protection without unduly constraining investor choice and market innovation.

The Playing Field is Level

The Notice indicates that CSA Staff believe that regulatory intervention is required to "level the playing field" between different types of funds or, more specifically, between the managers of open end mutual funds and CEFs. We believe a level playing field exists between different types of funds and their managers.

The distinction between a mutual fund manager and a non-redeemable investment fund manager is not one recognized at law. An IFM is free to launch any type of fund it wishes. Many IFMs manage more than one type of fund (and some manage mutual funds, CEFs and ETFs). Raising the cost to the IFM of bringing one type of fund to market does not enable them to "better compete".

The objectives of securities regulation are investor protection and market efficiency. The latter includes the promotion of capital formation and investor choice. We have addressed many of these concerns above, illustrating (i) how and why the regulatory requirements for CEFs differ from those applicable to mutual funds and (ii) that CEFs have introduced significant product innovation to the marketplace. The fact that CEFs do not fit squarely into a regulatory regime (that was not designed for them) does not necessarily mean that they present more of an investment risk to the investing public. Investors in the Canadian marketplace benefit from this wide array of choice, which offers accessibility to new product initiatives and portfolio diversification. Absent a compelling reason, new regulatory requirements should not restrict investor choice, product innovation and capital raising.

Until the CSA has had an opportunity to fully consider the reformulation of NI 81-102 and NI 81-104 in tandem, to the extent any investor protection concerns arise in respect of a CEF, CSA Staff have the ability to address the issue through the prospectus review process.

Cost-Benefit Analysis

The CSA has consistently taken the view that the costs of regulation should not outweigh the expected benefits. Section 2.1 of the *Securities Act* (Ontario) specifically directs the OSC to have regard for the principle that "regulatory costs and other restrictions on the business and

[6] Notice of Proposed National Instrument 81-102 and Companion Policy 81-102CP and proposed rescission of National Policy Statement No. 34, National Policy Statement No. 39 – Mutual Funds (1997) 20 OSCB (Supp. 2) published on June 27, 1997 at p.4, quoting from Warren M.H. Grover and James C. Baillie "Proposals for Mutual Fund Law for Canada", Vol. 1 Commentary, Consumer and Corporate Affairs Canada, 1974 at p.5.

investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized".[7]

The importance of undertaking a careful cost-benefit analysis of rule proposals was recently emphasized by the OSC in its Statement of Priorities released on April 4, 2013, in which it included the following priority to address in the current year:

> "Demonstrate the OSC's effective use of research, data and analysis through: (a) improved cost-benefit analysis and rules proposals and (b) use of data and analytical approaches."[8]

It would assist the comment process if the CSA would make available the analysis that it has undertaken. This would help us to better understand the basis for the draft proposals.

III. Core Operational Requirements Which We Support

We support each of the following eight proposals in the Notice (including each of the three proposals initially proposed in Staff Notice 81-322). We have conferred with CSA Staff during July to provide input on the details of such proposals and support their implementation on an accelerated basis.

*1. **Part 4 - Conflicts of Interest***

We agree with the principles encompassed by the proposed conflicts of interest provisions. We encourage the CSA to harmonize and simplify the conflict of interest provisions that appear in Section 111 of the *Securities Act* (Ontario), NI 31-103, NI 81-102 and NI 81-107 to make them more user friendly.

*2. **Part 5 – Securityholder and Regulatory Approval for Fundamental Changes***

We agree with extending the application of Part 5 of NI 81-102 to CEFs. This includes approvals required in connection with conversions, approved mergers and the termination of a CEF, all in the manner described in the Notice. Proposed s.5.1(h) mandates that the IFM bears the cost in connection with a conversion. This assumes (without the benefit of explicit analysis) that conversions (and mergers) are for the benefit of the IFM. In many instances this is not the case.

*3. **Part 6 - Custodianship Requirements***

We agree with extending the application of Part 6 of NI 81-102 to CEFs.

*4. **Part 9 - Sale of Securities***

We are prepared to accept the introduction of the anti-dilution provisions contemplated by sections 9.3(2) and (3) of NI 81-102. We note that, as drafted, the proposals introduce some uncertainty in the pricing of such offerings and so would suggest that the CSA adopt a formulation that allows the price of the offering to be fixed based on the most recently determined NAV prior to the pricing of the offering. Otherwise, it is not possible to know whether an offering can proceed.

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[7] *Securities Act*, RSO 1995, see S.5, (s)2.1(6).
[8] Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2014, OSC Notice, (2013) 36 OSCB 3423 (4 April 2013) at 5.

While the reasoning in the Notice proposing to prohibit CEFs from issuing warrants is unclear, we acknowledge that industry practice has moved away from the use of warrant offerings to raise capital for a fund.[9]

5. ***Part 10 – Redemptions***

We agree with the proposed restrictions on redemptions for CEFs. The mechanics of redemption should be fully disclosed in the CEF prospectus.

6. ***Part 11 – Comingling of Cash***

We agree with the application of the provisions of NI 81-102 relating to the holding of monies from sales and redemptions in a trust account should apply to non-redeemable investment funds and have provided CSA Staff with technical drafting suggestions relating to transfer agents and CDS Clearing and Depository Services Inc. ("**CDS**") in respect of this requirement.

7. ***Parts 14 and 18 – Record Date Requirements and Securityholder Record Requirements***

We agree with the proposals that CEFs set record dates in accordance with Part 14 of NI 81-102 (subject to an exemption for exchange listed CEFs and for mutual fund roll-over transactions by flow-through funds). We also agree that, subject to these exemptions, CEFs should maintain and make available securityholder records in accordance with Part 18 of NI 81-102. We note that unlike mutual funds, most CEF are book-entry only (and uncertificated) through the facilities of CDS, so securityholder records are necessarily limited.

8. ***Part 15 – Sales Communications***

We agree with the proposal to apply the provisions in Part 15 of NI 81-102 to sales communications of CEFs, subject to certain modifications that recognize differences between mutual funds and CEFs.

IV. Other Issues Identified in Extension Notice

There remain three sets of proposals in respect of which the Extension Notice specifically requested comment where we are not in agreement. These relate to investment restrictions, fund-of-fund structures and organizational costs for new CEFs.

Investment Restrictions

The Notice recognizes that CEFs differ from mutual funds in certain respects, but suggests that such differences do not "provide a sufficient policy basis to support the absence of any investment restrictions". The Notice suggests that one of the reasons to impose NI 81-102 investment restrictions on CEFs is that they "establish parameters for investment funds to meet the expectations of retail investors who invest in pooled investment products" (with a footnote giving the example of "diversification requirements for retail investors who benefit from greater diversification through investing in a fund compared to investing on an individual account basis").

[9] We note, however, that there are circumstances in which certain issuers have taken the view that the benefits of a warrant offering may outweigh the costs of moderate dilution (given that the offering may lead to enhanced liquidity and improved economies of scale as fixed costs can be spread over a larger base). Such determinations are typically referred to the CEF's IRC for their approval.

One of the fundamental premises underlying the various national policies that were collected into National Policy 39 and subsequently reformulated as NI 81-102 was that the mutual fund industry had successfully educated the public as to the benefits of that product and, in particular, the portfolio diversification advantages it affords the smaller retail investor. Accordingly, rules were developed to impose appropriate concentration limits on mutual funds to ensure that they achieve such portfolio diversification. While these rules have clearly served the mutual fund industry and its investors well, their relevance for CEFs is not evident.

As noted above, in the CEF sector, liquidity, leverage, shorting and other investment tools are determined by the issuer and investment dealer on a given offering based on what is appropriate for a particular CEF having regard for its investment objectives and strategy. A number of factors are taken into consideration in determining appropriate limits. For example, investors in CEFs are not necessarily seeking diversification in a particular fund.

Further, just because many CEFs comply with certain limits on leverage, etc., this does not mean that all CEFs should be required to adopt similar limits, or that such limits reflect industry best practices. This disregards the specialized nature of CEFs and has the potential to stifle innovation and investor choice. Any proposed thresholds should take into account investment strategy, rather than adopt thresholds based on parameters that most (or even all) of the existing CEF products comply with today.

It has been suggested that the proposed thresholds could be adjusted so as to avoid immediate adverse impact on existing CEFs. Such an approach looks at the market at a static point in time – it cannot anticipate (or facilitate) product innovation, nor does it address how these thresholds might interact with subsequent revisions to NI 81-104.

One area that requires additional attention is the need to refine existing definitions which apply to these investment restrictions. For example, what should be included in “leverage” when determining whether an IFM is in compliance? What should be included in “illiquid” investments? It is our belief that given there is no immediate harm that needs to be addressed, reform should be undertaken in connection with the development of the Alternative Fund Framework.

Unfortunately it is impossible to analyse fully the impact that the proposed investment restrictions would have on CEFs without knowing more about the proposed Alternative Funds Framework. If the Alternative Funds Framework were to provide a viable framework for new funds, certain investment restrictions applicable to CEFs (for e.g., illiquidity, concentration, restrictions to investments in physical commodities, leverage, use of derivatives and short selling) might be less problematic. However, with the Alternative Funds Framework only being proposed at a highly conceptual level, it is impossible to know if it would provide a viable alternative for the CEF sector.

Concentration Restriction

Concentration restrictions are imposed on mutual funds because of the need to maintain liquidity where a fund is redeemable on demand. As previously noted, the reason for imposing a concentration restriction on CEFs (that are not redeemable on demand), other than to address the specific liquidity requirements of the particular fund, isn’t evident.

The Notice is accurate in observing that many CEFs have a 10% concentration restriction. In many cases this reflects a diversification objective, whether for risk management or for investment reasons. However, in some cases, CEFs adopt a 10% concentration restriction in order to qualify as a mutual fund for purposes of the *Income Tax Act* (while not being a mutual fund for securities law purposes).

There are situations outside of those referred to in the proposed rule as “fixed portfolio ETFs”, where the investment thesis of a CEF involves concentration higher than the proposed 10% limit. By way of example, a CEF that provides exposure to the Canadian banking, insurance or wireless industry would have fewer than ten investment positions and would by default have greater than 10% concentration by name. Investors are not restricted from buying the underlying companies and, accordingly, we submit that they should not be restricted from investing in a CEF that provides exposure to such a limited number of issuers and also might use leverage or employ a covered call overly strategy designed to reduce volatility and increase cash income.

One product that was popular several years ago is a split share fund that may have a concentration exposure of 100% to shares of one underlying issuer. The structural form of this product splits the returns from the underlying security into a low risk dividend tranche and a leveraged capital appreciation tranche. Such products have been offered for years, catering to specific investor objectives. We assume that such products will be covered by the proposed carve out for fixed portfolios of publicly traded equity securities but are concerned that products that do not identify the issuers by name (such as an investment in the 10 largest North American life insurance companies) would not.

Having regard for the foregoing, we have proposed to CSA Staff a concentration restriction of 15% of net asset value, but with a broader exemption for rules-based or formulaic portfolios (which would permit active trading in the shares of the specified portfolio universe) and a look-through for fund-of-fund investments. Absent such definitional modifications to the proposed restriction, we would suggest deferral of this proposal for consideration in the context of the Alternative Fund Framework.

Investments in Illiquid Assets

Illiquid asset restrictions are most relevant as they relate to the need for liquidity to fund daily redemptions at NAV. In contrast to mutual funds, CEFs are typically redeemable, at most, once annually at 100% of NAV. Typically, an investor’s primary source of liquidity is the TSX listing. Hence, the need for portfolio liquidity at all times in order to meet redemption requests is dramatically reduced. In addition, CEFs frequently provide investors with access to asset classes that are not otherwise available to retail investors, which may involve illiquid investments. For example, a CEF may purchase securities in private placements where a four month hold period does not impact the liquidity requirements associated with the annual redemption right.

It should also be noted that the definition of illiquid investment may, as a technical matter, include some highly liquid securities for which “public quotations” are unavailable because the securities trade only in an institutional market. For example, senior loans and high yield bonds are normally traded in the institutional market (to which the portfolio managers of CEFs have access). Although at any time bid and ask prices may be available from multiple institutions which make a market in these investments, they may constitute “illiquid assets” as defined in NI 81-102 because, in the market which they trade, there are no public quotations in common use which are widely available to retail investors. By way of example, the market for senior loans is sufficiently robust to provide accurate pricing and sufficient liquidity to meet portfolio management objectives (i.e. the ability to trade positions), as well as to meet liquidity requirements for purposes of annual redemptions. We also note that derivative strategies often involve significant use of OTC derivatives which are caught by the current definition of illiquid assets yet may trade on very liquid markets.

We believe the definition of "illiquid asset" should be updated. With an appropriate definition of illiquid assets, we would support a threshold of 25% of NAV for CEFs to invest in illiquid assets (with the ability to seek exemptive relief in those cases where the investment strategy calls for higher levels).

Securities Lending, Repurchases and Reverse Repurchases

We support additional disclosure requirements designed to ensure that investors are fully informed of the securities lending, repurchases and reverse repurchases to be engaged in by a CEF.

For the reasons outlined below, we are opposed to imposing limits on such activities. Securities lending can be a valuable source of income to investors in a CEF. It isn't clear how restricting the percentage of a fund's assets that can be lent protects (or mitigates risk to) the lender. Instead, we suggest that regulatory restriction should focus on the quality of collateral (including the credit rating of the borrower) and on ensuring that there is full disclosure to the potential investor. We would also note that repurchases and reverse repurchases are now permitted in open end funds.

Fund-of-Fund Structures

While the "character conversion" provisions of the recent federal budget will preclude some structures that provided exposure to underlying funds, we expect that there will be other circumstances where it is appropriate for CEFs to carry out their investment objectives by obtaining exposure to underlying funds or investing indirectly through underlying funds. As a result, we support the proposal that CEFs should be able to obtain exposure to an underlying mutual fund that is not subject to NI 81-102. We believe that a carve-out from s. 2.5(2)(a) of NI 81-102 would be effective to achieve this result and that it would be suitable to make the carve-out conditional on the underlying fund adopting investment objectives and restrictions designed to achieve, either by direct investment or by virtue of the specified derivative by which the CEF obtains exposure to the underlying fund, the investment objectives of the CEF. We note that the investment objectives and restrictions of the underlying fund will not be identical to those of the CEF. For example, the CEF may have a distribution objective whereas the underlying fund may not pay regular distributions (e.g., partial pre-settlements of the specified derivative are funded by redemptions of securities of the underlying fund). Similarly, the investment restrictions of the CEF may relate to tax issues applicable to the CEF (for example, mutual fund qualification for tax purposes) or issues in connection with the specified derivative.

To date, the prospectus of the underlying funds (normally non-offering prospectuses) has been required by the regulators to be filed only in Ontario and/or Quebec in order for the underlying funds to become reporting issuers in those jurisdictions and hence subject to NI 81-106. We submit that, if an underlying fund becomes a reporting issuer in at least one Canadian jurisdiction, the objective of making continuous disclosure relating to the underlying fund publically available to investors via SEDAR is satisfied. We do not believe that requiring the underlying fund to become a reporting issuer in all of the jurisdictions in which the CEF offers its securities would enhance investor protection. Instead, it would impose an unnecessary and ongoing cost burden on the underlying fund, negatively impacting returns to investors.

We also wonder about the utility of requiring delivery of the prospectus of the underlying fund to investors in the top fund, as has been required to date, since its prospectus is required to provide full, true and plain disclosure in respect of the securities acquired by investors.

It is proposed that CEFs not be permitted to invest in other CEFs. We submit that this is an unnecessary restriction. Concerns about leverage and other investment restrictions could be addressed by requiring that any applicable leverage (or other) threshold is calculated on an aggregate basis taking into account leverage in the underlying CEF.

We would also point to several CEFs that have provided exposure to funds that are not reporting issuers.[10] These funds have been constructed in reliance upon a long standing practice that allowed that, if a portfolio holding constituted less than 40% of a fund's NAV at the time of investment, the offering was not viewed as an indirect offering and, accordingly, the portfolio holding was not required to file a prospectus to become a reporting issuer. We see no investor protection benefits accruing to investors by eliminating the availability of this structure.

Organizational Costs

The matter of requiring an IFM to bear organizational costs constitutes a significant departure from the position adopted in 2012 on the matter of offering expenses reflected in the amendments to NI 81-102 relating to expenses paid on the launch of ETFs which are not in continuous distribution. Prior to the adoption of these amendments, the CSA acknowledged that, while conventional mutual funds are prohibited from reimbursing their manager for organizational costs on the basis that these costs would be prejudicial to initial investors, this was not the case in a one-time offering where all of the securities of the fund are sold on a single closing and not through continuous distribution. This continues to be the case.

Levelling the Playing Field

Different types of funds have different cost structures, which are largely imposed by regulation and, to that extent, are not discretionary. For example, it is significantly more expensive to launch a CEF on a long form prospectus, pursuant to a process that involves registered investment dealers and their counsel, an auditor, and a thorough due diligence review – costs generally associated with investor protection efforts – than it is to launch a conventional mutual fund. A sample budget for a simple CEF offering is set out below:

Filing Fees	*$ 25,000*
Listing Fees	*$ 20,000*
Auditors Fees	*$ 15,000*
Issuer's Counsel Fees	*$250,000*
Agents' Counsel Fees	*$125,000*
Local Counsel Fees	*$ 10,000*
Printing	*$ 50,000*
Translation	*$ 40,000*
Marketing	*$ 65,000*
TOTAL:	*$600,000*

[10] Examples of this type of product include Propel Multi-Strategy Fund, Star Hedge Managers Corp and Star Hedge Managers Corp II.

It should be noted that substantially all of these costs (with the exception of certain marketing costs) are non-discretionary and can be attributed to "investor protection" focussed regulatory requirements.

In contrast, the legal fees associated with adding a new mutual fund to an existing simplified prospectus are often less than $20,000 – approximately 5% of the legal fees incurred on a typical CEF offering.

We note that there is nothing that precludes IFMs with a substantial mutual fund platform from launching a CEF. In fact, several have done so.

As noted below, the Notice indicates that the CSA expects (and we concur) that organizational costs paid by the IFM will be recouped through incremental management fees. We note, however, that the IFM would still be required to initially fund the organizational costs. Based on the budget above, we believe that this could serve as an entry barrier, having a material detrimental impact on competition (especially with respect to smaller, less well capitalized IFMs) and stifling new entrants into the market.

Efficiency

The recently announced CRA amendments known as "Character Conversion Measures" have had the effect of eliminating the two-tier fund structure that has historically been the most expensive in the CEF space. Many of the material agreements and much of the required prospectus disclosure have become standardized, and while costs will necessarily be higher for novel and complex products that require additional structuring and diligence, many significant aspects of these offerings require less legal involvement than previously. Accordingly, we do not anticipate that CEF offerings will become more efficient if IFMs are required to pay the organizational costs.

Alignment of Interests

As noted above, there is greater capital at risk on the launch of a CEF than on the launch of a mutual fund. In connection with such a launch, the IFM must be prepared to absorb the loss of capital occasioned by a failed deal, a motivation that aligns the interest of the IFM with investors to keep offering costs down. Interests are further aligned by the fact that, while there are typically annual redemption rights at NAV, there are very limited opportunities to grow the assets of the fund by way of follow-on offerings.

For the last several years, market practice has required that offering expenses borne by CEFs be capped at 1.5% of gross proceeds of the offering. By requiring the IFM to fund offering expenses that exceed this cap, industry participants have ensured that the IFM's interests are better aligned with those of investors, thereby contributing to cost efficiencies on the launch of a new CEF.

The CSA has, commendably, made a point of not assuming responsibility for price regulation. Yet there is considerable risk that this is likely to occur by requiring IFMs to pay for organizational costs. The CSA should expect these costs will be passed on to investors through incremental management fees. It is unlikely that the management fee would ever be reduced once the manager has recouped organizational (and associated) costs. Hence, over the longer term, an investor is almost certainly going to pay more through increased management fees than in the current model (where offering costs paid by the CEF are capped). Moreover, unitholder redemption rights may be delayed or reduced in order for the IPM to ensure that assets are retained long enough to earn back the capital it invested in launching the CEF.

As the CSA notes, mutual fund managers recoup the costs of a launch of a new fund through an on-going management fee that is typically higher than that charged for a CEF. By asking investors to pay a portion of the organizational costs, the IFM of a CEF is able to offer investors a lower management fee compared to what is typically charged for mutual funds.

Regulatory Arbitrage

The CSA also express concern about the potential for "regulatory arbitrage" particularly, we understand, as it relates to an investment fund conducting an IPO as a CEF and later converting to a mutual fund. If this is the concern, we would suggest a requirement for the IFM to refund the organizational costs borne by a fund if it converts within a prescribed period following its initial closing or if the intention to convert is not disclosed in the fund's IPO prospectus.

The CSA acknowledge that the proposed change may adversely affect market access. It would be our expectation that the proposed change to the economic model that has governed CEFs since their inception would favour IFMs with significant capital resources and therefore contribute to a CEF market with a similar profile to the existing mutual fund market – one dominated by a few very large players. We do not believe that this is in the long term best interests of Canadian retail investors or Canadian capital markets generally.

V. Other Issues Raised in the Notice

As it is our understanding that these proposals are not being considered for immediate implementation (but, rather, as part of the next phase of the Modernization Project), we thought it would be most useful to focus our comments on the issues specifically identified in the Extension Notice. While our views on these other issues are limited by the lack of a coherent set of proposed reforms and are likely to evolve in the course of the next phase of the Modernization Project, we provide some preliminary input in Appendix A to this letter. We would be happy to discuss any of these issues with the CSA.

VI. Grandfathering

Assuming any of the proposals in the Notice which we have raised concerns about are ultimately adopted, we submit that existing CEFs should be grandfathered from the provisions of proposed NI 81-102 and NI 81-104. In the interests of market efficiency and transparency, informing the market of such an intention as soon as practically possible would be beneficial. In any event, grandfathered funds should continue to be able to conduct their business, operations and affairs in all respects in compliance with their constating or governing documents and on the basis previously approved by the CSA (and those who have chosen to invest).

If new NI 81-102 and NI 81-104 compliant funds do a better job of meeting "the expectations of retail investors who invest in pooled investment products", then investors will have the choice to sell or redeem their grandfathered funds and buy new ones.

We submit that a transition period for existing CEFs is not appropriate for at least three reasons. Firstly (as is noted in Appendix A), certain issuers, such as mortgage investment corporations ("**MICs**") or other funds that do not fit within the Alternative Fund Framework, would be required to either wind-up or convert to regular corporate issuers. Secondly, the proposed amendments are inconsistent with the investment decision made by investors and their legitimate expectations or the commercial decision made by the IFM in launching the fund. We believe that it would be unfair to have investors and/or IFMs pay for amendments that are inconsistent with the bargain that was entered into at the time of investment. Thirdly, the costs and disruption associated with a requirement to transition an entire fund family would be significant for CEF managers and investors. The costs and logistics of amending fund documents, obtaining securityholder approvals, if required, and the associated notice and continuous disclosure requirements would be untenable. Will CEFs be required to offer special rights of redemption? Would it not be fair for investors to vote on this at the fund's expense (presumably, their preference will be for existing CEFs to be grandfathered) rather than have their existing investment product mandatorily re-structured? What if investors don't approve the changes? When all managers are forced to "align their portfolios with new requirements" in the same 18 month window, what will be the impact on the fund (tax implications, rebalancing etc.) and the markets for such securities? Will there be a market for the affected securities? What will happen to track records for "aligned" portfolios?

The grandfathering of all existing CEFs will lead to the least confusion and inequity for investors and all other market participants. It will take time for the investment community to adjust to two new investment fund regimes (or more, depending on what becomes of MICs and non-alternative investment funds), let alone deal with transitioning existing CEFs (or new CEFs developed before any proposed rule is implemented). Imposing a new regime on existing CEFs does not level the playing field or foster either investor protection or competition; it jeopardizes a viable alternative currently available to investors.

A statement from the CSA on grandfathering will help address the uncertainty that the prospect of investment restrictions and the Alternative Funds Framework has visited on the CEF market.

VII. Conclusion

We support the specific proposals that were signalled by the CSA in Staff Notice 81-322 two years ago, and most of the other proposed Core Operational Requirements. However, we have serious questions and concerns about several of the other proposals introduced in the Notice.

It is difficult to respond to the suggested changes to NI 81-102 in the absence of concrete proposals for NI 81-104. CEF market participants should be able to ascertain whether they will be able to develop and offer new CEF products in substantially the same manner as they are now able to do. We respectfully submit that it would be better to continue to regulate CEFs substantially on the basis that they are currently regulated and to develop amendments to NI 81-104.

In recognition of the growth of alternative asset classes and strategies and investor interest in investment products based on alternative asset classes and strategies, we agree with the proposed approach of modernizing NI 81-104 so as to increase its ambit beyond commodity pools to include Alternative Funds. We are optimistic that this approach may provide opportunities for products suitable to the needs and risk tolerances of investors. We recognize that the Alternative Funds Framework is at an early stage of development and hope we will be afforded the opportunity to engage with CSA Staff in developing a workable regulatory framework.

The industry is a highly regulated and stable one. Assets under management have not varied significantly in the past decade and the vast majority of CEFs held up well through the unprecedented conditions of the global financial crisis. While different, there is nothing to suggest that their construction, distribution process, management performance or regulatory framework are inferior to that in respect to mutual funds. In contrast, there are many reasons why conflating the two regulatory frameworks could detract from investor protection (and choice) and market efficiency.

We believe CEFs are fulfilling their role as a complement to mutual funds, individual securities and other less sophisticated financial products. The CEF industry innovates and involves highly qualified specialists in a variety of professions and in doing so it bolsters the Canadian capital markets and creates jobs.

If CEF regulation is to be modernized, this is an opportunity to devise a comprehensive, made in Canada framework. This should be done in consultation with CEF market participants including IFMs, portfolio managers, dealers, custodians, auditors, legal advisers and the TSX and IIROC. In formulating CEF regulation, we should not focus only on how CEFs are similar to mutual funds, but on their own attributes and how such attributes can be maintained and fostered in a fair and efficient capital market.

In the interim, to the extent that CSA Staff can justify urgency in addressing any of the issues in respect of which we have raised substantive concerns, we would recommend the approach recently suggested by IOSCO in its Principles for the Regulation of Exchanged Traded Funds Final Report (June 2013). The focus of this report is on enhanced disclosure, with which we have no issue. The Report is consistent with IOSCO's assessment methodology which recognizes that inappropriate regulation can impose unjustified burdens on markets and inhibit their growth and development, rather than recognize the benefits of competition in the marketplace and facilitate capital formation and economic growth.

We look forward to continuing to work with you on this initiative.

Ed Waitzer

Edward J. Waitzer

On behalf of BMO Capital Markets, CIBC, National Bank Financial, RBC Capital Markets, Scotiabank and TD Securities

Appendix A

Comments on Other Issues Raised in the Notice

Leverage

We do not believe that restricting the use of leverage by CEFs to borrowings is appropriate or necessary to achieve the CSA's stated objective of ensuring that the regulatory approach with respect to CEFs continues to adequately protect investors. The current regulatory framework places registration requirements and standards of care on IFMs and portfolio managers, includes the self-regulation of investment dealers (through IIROC) and provides specific disclosure requirements for CEFs. IFMs and portfolio managers have specific expertise and must register and be regulated accordingly. We submit that the current framework is appropriate as the level and type of leverage for a given CEF is highly subjective and should be based on the determination of the asset class (e.g., debt vs equity, investment grade vs non-investment grade) and applicable market participants. The Notice proposes maximum leverage equal to 30% of NAV. While simple in concept, this cap may be limiting in terms of different forms of leverage (e.g., for hedging purposes).

As observed in the Notice, there is no single standard maximum leverage amount among CEFs and, in fact, since October 2010 over 50 CEFs have come to market with permitted leverage in excess of the CSA's proposed cap on cash borrowing of 30% of NAV. The fact that a number of CEFs have voluntarily imposed borrowing restrictions demonstrates that the market is operating efficiently to provide investors with a range of product choices. Determination of appropriate leverage should be left to the discretion of fund managers and directors/trustees who are in the best position to determine what is in the best interests of the fund and the scrutiny by the investment dealers who sign the prospectus.

We believe that the reference point referred to in the Notice of a majority of CEFs limiting borrowing to between 10% and 33% of NAV is incorrect. Our analysis suggests that such a threshold would put over half of the CEFs issued in the last 12 months offside.

Certain investment objectives and strategies warrant more leverage than others and where there is demand for a given investment strategy and where such strategy is determined to be appropriate for a given investor, we do not think it is appropriate to restrict the availability of such an investment product on the basis of an arbitrary cap on the amount or type of leverage. As noted above, CEF investors are assisted by industry professionals who are required to do a suitability analysis. The current regulatory structure is designed to ensure CEF investors who have the benefit of full, true and plain disclosure and the advice of registered advisors working in the investment dealer channel, enjoy access to a broad array of investment strategies.

We submit that any concerns that the CSA may have with respect to leverage should be addressed through enhanced disclosure. We note that currently disclosure regarding leverage typically appears in both the summary and main body section of the prospectus (both under investment strategy and investment restrictions) and sets out the maximum amount of leverage as a percentage of the portfolio or total assets as well as a percentage or ratio of debt to NAV **in** accordance with Item 6.1 of Form 41-101F2. We would suggest that such disclosure be mandated to appear in the summary section (which though not currently required by Item 3 of Form 41-101F2, generally is included in the summary as a market convention) as well as on the face page of the prospectus. Additional disclosure regarding leverage could also be mandated including whether the borrowing is secured or unsecured, whether the fund is permitted to borrow from a foreign financial institution and as to how the leverage is obtained.

We agree with the CSA that a clear and coherent framework is needed for CEFs. As the current framework for CEFs relates to leverage, the existing basis for calculating leverage (per Item 6.1(1)(b) of Form 41-101F2) is a ratio equal to: (total long positions including leveraged positions plus total short positions) divided by the net assets of the investment fund does not necessarily reflect the "riskiness" of the investment. For example a fund with a "long-short" strategy would have a high leverage ratio but may be relatively low risk because the positions are hedged against each other. We submit that leverage must be clearly and consistently defined and disclosed. Any such definition should represent an objective measure of risk.

We note that currently a CEF can obtain leverage in several different ways including through shorting, margin, derivatives, through investment in other funds or futures, as well as through conventional borrowing. While leverage may be employed to enhance the fund's return, it may also be used to hedge the portfolio from certain risks. The CSA should consider a purposive approach to addressing leverage limits, if indeed limits are required, including the possibility of excluding positions assumed for hedging purposes from the calculation of a fund's leverage. In this regard, we suggest that the CSA undertake a review of risk principles and management rather than creating an arbitrary cap that could contribute to increased risk.

The Notice also raises the possibility of limiting CEFs to borrowing from a "Canadian financial institution" (as such term is defined in National Instrument 14-101 – Definitions). The CSA suggest that there may be benefits associated with borrowing from a "Canadian financial institution" such as "additional monitoring and controls" over a CEF's cash borrowings.

Additional information is needed with respect to the rationale and any potential benefits of this proposed amendment before we can adequately assess the advantages and disadvantages of the proposed change. The effect of this restriction would be to limit the sources of financing for CEFs, which would have the likely effect of reducing liquidity and increasing the cost of financing and ultimately the cost to investors. It is unclear whether this proposed change is meant to address a perceived risk associated with (i) foreign lenders, or (ii) Canadian lenders who are not financial institutions. In any event, even if a fund is in breach, the terms of the loan agreement and related security will govern the rights of the parties. One would expect that in a breach scenario the behaviour of the lender will be the same whether it is a Canadian or foreign bank or financial institution. In all cases, the lender will attempt to enforce its rights under the applicable loan and security agreements.

Investments in Mortgages

The Notice specifically asks for comment on the impact of the proposed restriction on investments in a government or government agency ("**non-guaranteed mortgages**") for publicly offered non-redeemable investment funds. If the proposed restriction is adopted (without grandfathering) the MICs that are currently CEFs would be required to either wind-up or convert to regular corporate issuers. The reason for this is that the MICs do not invest in guaranteed mortgages and such investments would not fit within their investment objectives or strategies.

In the Notice, the CSA makes the comment that "we have observed that there are currently a limited number of existing publicly offered non-redeemable investment funds that have investment objectives of investing in non-guaranteed mortgages." There are no CEFs that have as their investment objective investment in guaranteed mortgages. The proposal would effectively eliminate MICs from the investment fund category (and existing MICs would have to be grandfathered or given an indefinite transition period to move to an indeterminate alternative regime.

In the Notice the CSA expresses the view that "mortgages that are not fully and unconditionally guaranteed by non-guaranteed mortgages may not be appropriate investments for publicly offered investment funds." It is not clear in reading the Notice or CSA Staff Notice 31-323 *Guidance Related to the Registration Obligations of Mortgage Investment Entities* ("**Staff Notice 31-123**") as to why the CSA is proposing to create this distinction between guaranteed and non-guaranteed mortgages. CSA 31-123 makes no mention of there being a distinction between the types of mortgages that an investment fund may invest in and instead deals with the activities undertaken with respect to the mortgage origination process and who administers the mortgage, among other elements. We note that there is also no guidance on this point in the most recent Investment Funds Practitioner (May 2013) which also deals with MICs.

If the CSA has concerns from an investor protection standpoint, we would like to better understand the nature of such concerns. We are unclear how a mandated transition of MICs to the regulatory regime for issuers that are not investment funds would alleviate any concerns regarding investor protection. We note that dealer best practises (per the fact that an investment fund has a registered IFM and portfolio manager) would be lost.

One particular concern in removing MICs from the investment fund category is that on an initial public offering, they would no longer meet the original listing requirements of the TSX. Accordingly, the approach will create a significant barrier to entry to new entrants into this space which would have the unfortunate consequence of limiting investor choice. Absent changes to the TSX rules, a new MIC would need to raise funds in the exempt market first in order to have the appropriate financial performance to meet the TSX requirements for listing as a corporate issuer. In the event that the CSA decides to move forward with this proposal we would strongly encourage the CSA to engage in dialogue with the TSX prior to making a final decision which could severely hamper new entrants and investor choice.

Incentive Fees

We see no reason to restrict the types of fees that a CEF manager can charge. Investors should be free to choose investment funds based on an investor's appetite for risk and returns as well as a fund manager's performance and the level of fees charged, so long as they are properly disclosed.

The CSA suggests that the restrictions on mutual fund incentive fees should apply to CEFs that use "similar investment strategies". We have two comments on this approach. Firstly, "investment strategy" is not a defined term, so we are not sure on what basis such a comparison could be made. Secondly, we think that most active investment strategies are too subjective to permit an easy comparison. Even if such a comparison was possible, we note that compared to mutual funds, CEF managers typically have an investment mandate to use larger short positions, significantly more leverage, and to make extensive use of derivatives (both for hedging and non-hedging purposes). Therefore, a CEF's return and diversification benefits depend, to a greater degree, on the skills of the manager. By acting as an incentive for managers to generate positive returns, incentive fees (also called performance fees, performance bonuses or incentive allocations) align the interests of fund managers and investors.

NI 81-104 permits an incentive fee to be charged based on an internal, cumulative total return (as opposed to an external benchmark) of a commodity pool. These types of incentive fees are charged by many CEFs, including flow-through funds that have charged such fees for at least the past 15 years. Such incentive fees are highly standardized and well-understood. We submit that the standard set forth in NI 81-104 is appropriate for all CEFs, provided that the method of calculation of the fee is disclosed in the prospectus. Since incentive fees are reflected in a fund's management expense ratio, all investment funds will continue to comparable on the basis of both fees and investment returns.

Many CEFs charge incentive fees based on a cumulative total returns, but subject to hurdle rates of return or return thresholds which, in certain cases, are also subject to high water marks. A hurdle is the minimum return necessary for a fund manager to start collecting incentive fees. It is usually a fixed percentage, but it can be determined with reference to a measure such as LIBOR (or an equivalent) plus a spread.

It is submitted that incentive fees that are based on a cumulative total returns may be preferred by investors over incentive fees charged with reference to a benchmark for the following reasons:

(a) A cumulative total return incentive fee is easy for a fund manager to disclose and for an investor to understand;

(b) A cumulative total return incentive fee is not susceptible to the material differences that may exist between a benchmark and a fund's investment mandate, objective, or strategy;

(c) An appropriate benchmark or index may not exist;

(d) Where a single appropriate benchmark or index does not exist, a combination of multiple benchmarks (sometimes referred to as a "style benchmark", since it replicates the historical behavior of the fund manager) can be more representative as a benchmark than a single benchmark or index, but such a benchmark can be difficult both for managers to compile, maintain (i.e. components, weights, and rebalancing process etc.) and measure against. A style benchmark is also more difficult for investors to understand and compare; and

(e) An incentive fee based on a cumulative total return is only payable in respect of positive returns rather than returns that outperform a benchmark, which may permit an incentive fee to be paid when a manager outperforms a static or falling benchmark.

Naming Convention

We are not opposed to a requirement to disclose the type of investment fund such as is currently required under Item 1.3 of Form 41-101F2.

It is difficult to assess the impact of the term "alternative fund" in the absence of a fully developed NI 81-104 proposal.

We do not believe the term "alternative fund" is a useful categorization for specific asset classes or investment strategies. Within the CEF universe there are important distinctions among funds that are material and more relevant for inclusion in the name of a fund such as "Canadian", "Limited Partnership" and "Split Share". These naming conventions provide useful disclosure relevant to an investment decision whereas a generic term like "alternative fund" does not.