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August 23, 2013

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
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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 pleased to provide comments in response to the CSA Notice and Request for Comment published on March 27, 2013 (the "Notice") concerning the next phase of the CSA's previously announced modernization project (the "Modernization Project"). We note that these comments do not necessarily reflect the views of all lawyers of the firm or our clients.

Introduction

We are aware that there are market participants in the closed-end fund ("CEF") industry that have and will provide you with comments and concerns about the approach taken with respect to certain aspects of the Notice (the "Proposals"). Members of our firm have participated with CSA representatives in discussions regarding such issues. We wish to note that we share the serious concerns expressed by these market

participants with respect to the Proposals including that they represent substantial amendments to the existing CEF regime that appear to be made without rationale in some areas, a full appreciation of the differences between CEFs and mutual funds, an extensive consultation process with industry participants or evidence of a meaningful cost-benefit or regulatory impact analysis. In particular, we endorse the positions reflected in the letter dated August 22, 2013 signed on behalf of BMO Capital Markets, CIBC, National Bank Financial, RBC Capital Markets, Scotiabank and TD Securities.

We generally support most of the core operational requirements proposed in the Notice (including conflicts of interest, approval for fundamental changes, custodianship requirements, sale of securities, commingling of cash, record date requirements and sales communications) subject to certain modifications that recognize differences between mutual funds and CEFs, but we have concerns that other initiatives described in the Notice will adversely affect market efficiency and investor choice without having any meaningful effect on investor protection.

We also understand and appreciate the desire of the CSA to adapt the regulatory regime to deal appropriately with CEFs, mutual funds and “other” funds, for which you are proposing to introduce the “Alternative Funds Framework”. However, we have a fundamental concern about the CSA proceeding at this time with substantial amendments to the CEF regime before the details of the Alternative Funds Framework are set out. Simply put, it is impossible to comment properly on the proposal contained in the Notice without having a sense of the particulars of the Alternative Funds Framework or the effect that it will have on interrelated provisions. We have no way of knowing whether the Alternative Funds Framework will be a viable option for CEFs. If it’s viable, then some of our concerns regarding the Proposals will be of lesser importance; however, if the Alternative Funds Framework is not a suitable option for CEFs, our concerns will be critical and the pressure for exemptive relief will be significant. Accordingly, we do not believe that it would be appropriate to proceed at this time with the introduction of investment restrictions for CEFs.

However, notwithstanding this concern, we have provided some commentary on the Alternative Funds Framework that we believe may be helpful to your further consideration of investment restrictions generally.

Specific Comments

The following are our comments on the specific questions raised by the CSA in Annex A of the Proposal.

1. Annual Redemptions of Securities Based on NAV

Regular redemption privileges are fundamental to open-ended mutual funds and have always been recognized as a fundamental aspect of mutual funds. As the seminal work on mutual fund regulation in Canada noted in 1969 (the Report of the Canadian Committee on Mutual Funds and Investment Contracts – Provincial and Federal Study (the “1969 Report”)):

> “It is doubtful that the industry would have experienced the rate of growth which it has attained without the complete liquidity provided by the availability of the right to redeem, coupled with exact price quotation on a regular basis. In addition, the lack of availability of the right to redeem would have made it extremely difficult for distribution companies to engage in the continuous sale of shares or units which is another hallmark of the industry…The right of redemption is of such

importance that the investor is entitled to be protected against an unjustified termination of that right…" (p. 501)

What the 1969 Report emphasizes, and has been recognized since that time, is the fundamental importance of redemption rights to mutual funds. Indeed, recognizing and protecting mutual funds' ability to satisfy redemption on a timely basis has been a key element of mutual fund regulation since that time, resulting in rules, among other things, regulating liquidity of assets, pricing of securities and timely procedures for redemptions and payment.

We believe that treating CEFs as mutual funds if they have *any* redemption rights at NAV would be misguided and evidence a failure to understand one of the key differences between CEFs and mutual funds which is that occasional redemption rights may be available to holders of some CEFs, but they are not a fundamental component of such product. As a result, the panoply of regulation that is aimed at protecting redemption rights would not be properly applied to CEFs. We note that CEFs make available occasional redemption rights for a variety of reasons, including (a) to provide a mechanism to seek to reduce the discount at which its securities trade on a market compared to its NAV, or (b) to ensure that the fund maintains "mutual fund trust" status for Income Tax Act purposes.

We believe that it may be appropriate to apply certain rules to CEFs that offer redemptions at NAV on an occasional basis, but that the blanket reclassifying of CEFs as mutual funds would be a blunt regulatory approach that would be conceptually inappropriate and require substantial complexity in the rules to exempt CEFs from mutual fund rules that should not apply. The more correct approach is to assess which mutual fund rules should be properly applied to CEFs on a rule-by-rule basis.

In addition, this proposal, if enacted, would likely result in some CEFs removing the annual redemption right at NAV and therefore, among other things, impairing its securityholders' ability to ever cash out their investment at NAV.

2. Concentration Restrictions

The CSA conclude that elements of NI 81-102 represent "fundamental requirements" without disclosing the basis for this conclusion. In particular, the Notice discloses that one of the reasons to impose the NI 81-102 investment restrictions on closed end funds is that they "establish parameters for investment funds to meet the expectations of retail investors who invest in pooled investment products"; with a footnote which gives 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".

All would acknowledge that 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 done a tremendous job educating the public as to what a mutual fund was and promoting what they saw as the benefits of such a product, and in particular, the portfolio diversification advantages it afforded the smaller retail investor. Accordingly, appropriate regulation of such a product would serve to ensure that the mutual fund industry lived up to its promises to investors, and as a result, rules were developed to impose appropriate concentration limits on mutual funds to achieve such portfolio diversification. These rules have clearly served the mutual fund industry and its investors well for many years now. Their appropriateness for CEFs is, however, much less clear.

Portfolio diversification needs to be achieved (if at all) on an aggregate basis for an individual investor looking at his or her portfolio as a whole, or perhaps even on a broader basis, taking into account total household rather than individual investments. Justification exists for imposing such diversification at a product level only if that product is marketed, and then used, as the sole, or primary, investment or savings vehicle. As is noted in the Notice, diversification is a benefit to those who invest in a fund "as compared to investing on an individual account basis".

The point, of course, is that investors in a CEF do not generally invest in the fund instead of investing on an individual account basis. Investors invest in a CEF through an individual account at an IIROC dealer, along with other investments such as stocks and bonds, in the selection of which they are assisted by industry professionals of the highest qualifications who are required to do a suitability analysis taking into account their portfolio holdings as a whole. We would suggest that the best regulations would be those that let these professionals do their job, and not try to do at a product level what is already being done (to the extent appropriate) on a portfolio basis. To suggest otherwise reflects a misunderstanding of how CEFs are developed for, and used by, investors.

To suggest, as the CSA do, that since many CEFs use certain conventional strategies, all CEFs should be required to adopt the restrictions used by such funds because they reflect industry best practices is to misunderstand altogether the construction and sale of CEFs. When the participants in structuring a new CEF offering determine that a particular level of diversification, liquidity or leverage is appropriate, the decision has been made that these restrictions are consistent with the theme and objectives of the product and nothing more.

We are not aware of any basis for concluding that retail investors have an expectation that in purchasing a CEF they are purchasing a diversified portfolio representing a complete investment program. Certainly, with very few exceptions, CEFs have not been created, marketed or sold on that basis. CEFs are generally niche products designed around a particular investment theme or which attempt to achieve particular investment objectives in a particular way using particular investment techniques or securities. If you have consumer surveys that demonstrate investor perceptions about the nature of CEFs to the contrary, we would be pleased to hear of them; but it seems to us that you are proposing to regulate on the basis of assumed investor expectations that are not supported by the facts. To try to transform CEFs into listed mutual funds is to regulate so as to create a product that does not exist today and for which there is no evidence of investor need or, for that matter, appetite.

Finally, although the CSA recognize that CEFs differ from mutual funds in certain respects; they do not believe that "the differences provide a sufficient policy basis to support the absence of any investment restrictions". Importantly, this is not the basis for the creation of new law. Following Ainsley,[1] a very detailed process was established for the exercise of rulemaking authority. The process requires a detailed cost-benefit analysis and regulatory impact assessment and we note that the Notice fails to identify any particular harm or clear regulatory objectives against which the proposals could be judged or set out any empirical data on which such analysis could be based.

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[1] *Ainsley Financial Corp. v. Ontario Securities Commission* (1994), 21 O.R. (3d) 104 (C.A.) affirming (1993), 14 O.R. (3d) 280 CDN. Ct.).

3. Investments in Illiquid Assets

We believe that the principal issue associated with restriction on "illiquid assets" lies with deficiencies in the definition. "Illiquid assets" are defined primarily as a "portfolio asset that cannot be readily disposed of through market facilities on which public quotation in common use are widely available…" We understand that this definition captures securities and instruments that are highly liquid (in a commercial sense) at accurate prices, such as OTC derivatives and bonds that are traded on institutional markets, but that are not traded on "market facilities on which public quotations" are widely available.

We understand that other commenters have indicated that the questions raised by the CSA in respect of illiquid assets cannot be answered until the definition is "modernized", and we would concur with that view. Once the definition is "modernized", we could consider what the appropriate definition could be in light of the fact that the relevance of NAV (and the effect on NAV due to the sale of illiquid assets) is limited due to the limited redemption rights attached to CEFs and the fact that CEFs are not in continuous distribution in contrast to mutual funds.

We believe that there is no basis for distinguishing between the restrictions relating to concentration or illiquidity and the other investment restrictions, such as borrowing, that are being deferred to the next stage of the Modernization Project (on the basis that they are interrelated with NI 81-104). We are of the view that these investment restrictions are also interrelated with NI 81-104, and accordingly, these investment restrictions should be deferred as well.

4. Borrowing

The CSA suggest that there may be benefits associated with borrowing from a "Canadian financial institution" such as "additional monitoring and controls". We believe that CEFs may also prefer to borrow from other financial institutions perhaps because of preferential rates, better terms, or because of a pre-existing relationship with the institutional lender. While we appreciate that this definition would permit borrowing from affiliates of non-Canadian entities including for instance, US banks, we see no evidence justifying a conclusion that "additional monitoring and controls" exist or otherwise that it would be in the best interests of investors to be exposed only to Canadian financial institutions.

5. Investments in Mortgages

In the Proposals, the CSA states:

> "The CSA are of the view that mortgages that are not fully and unconditionally guaranteed by a government or government agency ("non-guaranteed mortgages") may not be appropriate investments for publicly offered investment funds."

We note that there is no discussion of the basis for the conclusion that this particular type of debt instrument is not an appropriate investment for publicly offered investment funds. There is also no discussion of why non-guaranteed mortgages couldn't be held by funds operating under the Alternative Funds Framework, a significantly less costly alternative to the transitioning proposed in the Notice.

It seems surprising that CEFs would be prohibited from holding non-guaranteed mortgages, while mutual funds may do so subject only to compliance with the provisions of National Policy 29 - *Mutual Funds*

Investing in Mortgages ("NP 29"). Perhaps the CSA are planning to abolish or amend NP 29 so as to prohibit mortgage mutual funds from holding non-guaranteed mortgages; it would be helpful if the CSA could clarify their intentions in this regard.

Assuming mortgage mutual funds will continue to be permitted to invest in non-guaranteed mortgages, subject only to a requirement that the maximum loan to value ratio be set at 75% (something most non-mutual funds would comply with as a matter of general prudence), it is unclear to us why this would not be sufficient for CEFs. There is no basis provided for an apparent assumption that non-guaranteed mortgages are acceptable when held by mortgage mutual funds, which are sold as a low risk investment through the MFDA channel to retail investors, but completely unacceptable when held by a TSX-listed CEF sold through an IIROC registered dealer.

We are concerned that the proposal to prohibit all investment funds from investing in non-guaranteed mortgages actually represents an effort to re-regulate mortgage investment corporations or other mortgage investment entities ("MIEs").

We note that some members of the CSA are of the view that MIEs should not be regulated as investment funds, although we understand that this view is not shared by all CSA members. As a result of this uncertainty, similarly-structured products are regulated in different manners – some as investment funds and some as industrial issuers. It appears that a "check-the-box" system for regulation of MIEs in Canada has been created, with issuers having the freedom to choose how their MIEs will be regulated.

The proposed prohibition on non-guaranteed mortgages, which on its face appears to be without rationale, can possibly be explained as an attempt to either shutdown all MIEs that are not restricted to investing in guaranteed mortgages (i.e., all of them as the low-rate interest paid on guaranteed mortgages would render such funds uneconomical to operate), or force them to be treated as non-investment funds. If this is the rationale for the proposed prohibition on non-guaranteed mortgages, we would suggest that this approach be abandoned, and that the CSA directly address the question of whether MIEs should be treated as investment funds.

It is somewhat troubling, though, if the CSA have concluded that MIEs properly meet the definition of an investment fund today, but do not wish to continue regulating them as such, and the mechanism to force them out of the investment fund world is to propose a ban on non-guaranteed mortgages, thereby rendering them uneconomical to operate. Arguably, if this were to be the case, what the CSA would be attempting to do is to amend the definition of the term "investment fund", otherwise found in the securities acts, without the proper rule-making authority for doing so.

We think that there needs to be much more transparency behind the proposed investment fund ban on non-guaranteed mortgages. In particular, the CSA need to clarify whether their current position is that the typical MIE is not an investment fund because it does not meet the existing definition of an investment fund (explaining how it does not), or whether their position is that while it does meet such definition today (explaining why it does), in light of all the circumstances, it would be more appropriate if they were regulated as NI 51-102 issuers.

If the view is that MIEs do not meet the definition of an investment fund as such definition exists today, then there are certain implications that would seem to flow from this conclusion. Absent some regulatory action (such as designating them to be investment funds on a temporary basis, to the extent the legislative power

exists to do this), no question of transition arises. That is, if MIEs are not investment funds, then they will not be subject to NI 81-102 as amended (including that they will not be subject to any ban on investing in non-guaranteed mortgages) or to NI 81-106 or NI 81-107 today, and would therefore have no need to comply with NI 81-102 as amended or with NI 81-107 today, and no legal basis for continuing to comply with NI 81-106. Similarly, no question of securityholder approvals of a transition to an NI 51-102 issuer arises: if as a matter of law an MIE is not an investment fund, then there is nothing for securityholders to approve.

If, on the other hand, the view is that MIEs do meet the definition of an investment fund, but ought not to, then a different set of implications follow. For one thing, all of the MIEs that filed as NI 51-102 issuers would be operating contrary to securities law. Exemptions or some other mechanism to exempt them from the consequences of being an investment fund today ought to be developed, pending changes to the definition of the term "investment fund" to exclude MIEs. For that is what we think needs to happen: rather than ban investment funds from holding non-guaranteed mortgages, which would not change their characterization as an investment fund or not, in hopes that they then "transition" to an NI 51-102 issuer (for which there is no current legislative basis), we would suggest that the CSA would need to amend the definition of the term "non-redeemable investment fund" to make it clear that MIEs are excluded. For example, paragraph (c) of the definition could be revised to read "that is not a mutual fund or a mortgage investment entity", although we appreciate that this would then require developing a definition of a "mortgage investment entity" that excludes mortgage mutual funds (which would clearly be caught by the definition of an MIE in CSA Staff Notice 31-323).

Alternatively, we would need to develop more fully a "check the box" system, in which the regulatory regimes are not triggered by meeting the definition of an investment fund or not, but by the election of an issuer.

Whichever way the CSA decide on this issue, we assume that uniform rules and the interpretation thereof will apply across Canada, including Alberta. We also note that to the extent this is definitional, whatever position is developed will apply equally to non-public MIEs; that is, if an MIE is not an investment fund, it will not need an investment fund manager, regardless of whether it is publicly offered or not.

It would also be helpful to understand whether the analysis that the CSA have put into MIEs would also apply to similar structures, such as issuers who hold collateralized debt obligations ("CDOs"). Often the only difference between a MIE and a CDO issuer is that the collateral securing the debt obligation held by a MIE is real estate and the collateral securing the debt obligation held by a CDO issuer is something other than real estate. But the same involvement of a sponsor in sourcing and originating the loans and other structural matters may apply equally to both. We are seeing numerous CDO offerings (mostly from the U.S. into Canada) on a private placement basis, but it is inevitable that this structure will sooner or later enter the public fund space, and it would be helpful to understand the regulatory response. Of course, once the CSA articulate whether their implicit decision not to regulate MIEs as investment funds is technical (they do not meet the current definition) or purposive (it is not appropriate for MIEs to be regulated as investment funds), the application of that position to similar vehicles may become readily apparent.

Finally, as you are aware, one of the reasons (indeed, often the only reason, in our experience) for an issuer to have effectively elected to be regulated as an investment fund is that the listing requirements of the Toronto Stock Exchange (the "TSX") are such that a newly created MIE could meet those requirements if characterized as an investment fund and not otherwise. Although this is not directly the CSA's issue, we suggest that in order to properly conduct the necessary cost-benefit analysis of these proposals, it would be

necessary to understand whether the TSX intends to delist existing MIEs (assuming that one way or another they are no longer to be investment funds) on the basis that as NI 51-102 issuers they no longer meet the listing criteria for that type of issuer, and what it intends to do with its listing requirements for MIEs going forward.

6. Fund-of-Fund Structures

This structure provides investors with exposure to the strategies of the underlying fund; therefore, the failure to provide a carve-out for CEFs would indirectly permit the fund-of-fund structures to be used only in the mutual fund universe. Therefore, we support the proposal that CEFs should be able to obtain exposure to an underlying mutual fund that is not subject to the investment restrictions set out in NI 81-102. However, we note that the investment restrictions of the top and the underlying fund will be different in certain respects (specifically, the top fund will have certain investment restrictions required for tax purposes), but we agree with the general premise that the underlying fund's investment restrictions should be consistent with the investment restrictions of the top fund which relate to the investment strategies.

We disagree that an underlying fund should be required to file a prospectus in order to become a reporting issuer. We believe that it is not necessary for the underlying fund to be a reporting issuer if the top fund undertakes to the regulatory authorities to include look-through disclosure of the detailed holdings of the underlying fund in its continuous disclosure. In the alternative, we submit that it would be sufficient for the underlying fund to file a prospectus in at least one Canadian jurisdiction as the fund's continuous disclosure will be publicly available in the other Canadian jurisdictions through SEDAR.

Additionally, we note that current practice is that if a portfolio of a fund (the top fund) includes securities of another fund (the bottom fund) that constitutes less than 40% of the top fund's NAV at the time of investment, the bottom fund has historically not been required to file a prospectus to become a reporting issuer. We submit that this type of offering does not constitute an indirect offering and therefore this position should be retained going forward.

7. Organizational Costs

The matter of offering expenses was not raised in Staff Notice 81-322 and we were surprised that it appeared in the form of draft legislation, particularly as this constituted a significant departure from the position on the matter of offering expenses reflected in the amendments to NI 81-102 relating to expenses paid on the launch of ETFs adopted in 2012. 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 were sold on a single closing and not through continuous distribution (See (2010) 33OSCB 5835). This continues to be the case.

Levelling the Playing Field

The CSA state that by requiring the manager to pay the organizational costs of launching a new CEF, the CSA will "level the playing field between mutual fund managers and non-redeemable investment fund managers…". Importantly, the distinction between a mutual fund manager and a non-redeemable investment fund manager is not a distinction recognized at law.

In the *Securities Act* (Ontario) ("Act") we have only a definition for "investment fund manager" ("IFM") and an IFM is free to launch any type of fund it wishes. In fact, many IFMs manage more than one type of fund and some IFMs manage all three types of funds. Understandably, these IFMs are frustrated and confused by regulatory initiatives that seek to enable their funds to "better compete" with one and other, and that seek to do so by raising the cost of bringing one type fund to market.

The fact is, different types of funds have different cost structures and these structures are largely imposed by securities legislation. For example, it is significantly more expensive to launch a CEF on a long form prospectus, pursuant to a process that involves registered dealers and their counsel, an auditor, a thorough due diligence review and an extensive regulatory approval process, than it is to launch a conventional mutual fund.

We note that there is nothing in the Act that would preclude an IFM with a substantial mutual fund platform from launching a CEF. These IFMs have generally chosen not to do so in part, because of the costs and risks associated with launching a CEF. Their experience has been that it is difficult to build a significant business by investing $600,000 in a single investment idea marketed over a period of six weeks and that their capital is put to better use leveraging their existing mutual fund platform.

Some of the IFMs that operate principally in the CEF market seek to launch up to four funds each year. Based on a conservative budget for organizational costs, the proposed amendment would require them to commit an additional $2.5 million to the CEF business. We respectfully submit that the proposed amendment unnecessarily interferes with commercial decisions regarding the allocation of capital made in the context of a properly functioning market.

Efficiency

The CSA also expect that requiring the IFM to bear offering costs will enhance the efficiency of CEF offerings. We note that generally, organizational costs have decreased significantly over time. 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 will require additional structuring and diligence, many significant aspects of these offerings require less legal involvement.

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. And, in connection with that 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. This risk is compounded by the fact that there are annual redemptions permitted at NAV (generally beginning 18 months following the closing) and that there are very limited opportunities to grow the assets of a fund by way of follow-on offerings.

The Notice fails to recognize the fact that, for the last several years, market practice has required that organizational costs borne by CEFs be capped at 1.5% of gross proceeds of the offering. The investment dealers that imposed this practice concluded that this resulted in an appropriate allocation of the cost of a new CEF between the manager and investors. By requiring the IFM to fund offering expenses that exceed this cap, industry participants have ensured that the IFM's interests are aligned with those of investors by seeking to minimize costs contributing to significant cost efficiencies on the launch of a new CEF.

Regulatory Arbitrage

The CSA also express concern about the potential for “regulatory arbitrage”, particularly, we understand, as it relates to CEFs converting to mutual funds. We note that an investor might be quite willing to bear its share of the organizational expenses of a fund launched as a CEF so that it’s able to achieve a scale sufficient to provide the diversification it promises and which promises daily redemptions at NAV in the future. We respectfully suggest that, if the CSA believe that it is improper that IFMs launch CEFs that later convert to mutual funds, they could simply require the IFM to refund the organizational costs borne by a fund if it converts within a prescribed period following its initial closing. We respectfully submit that changing the cost structure of the asset class is a disproportionate and unnecessary fix for a problem that we don’t believe exists.

As the CSA note, mutual fund managers recoup the costs of a launch of a new fund through an on-going management fee. By asking investors to pay a portion of the organizational costs, the IFM of a CEF is able to offer investors a lower management expense ratio (“MER”) than is generally available on mutual funds. Like any tax, we would anticipate that the costs of this regulatory burden would be passed on to investors. This would mean higher costs imposed over the life of a fund, not a desirable result given our current global standing on management fees charged by mutual funds (which, as reported by Morningstar in its most recent Global Fund Investor Experience report, is last among the 24 countries identified as our peers). Ironically, this would also mean that the IFM could be overcompensated over time for incurring this initial expense.

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 much the same profile as currently exists in the mutual fund market – a market 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. The CSA acknowledge that the proposed change may adversely affect market access. In our view, the impact on market access would not satisfy any meaningful cost-benefit analysis.

As part of the Modernization Project, we suggest that the CSA should also codify a carve-out from the obligation of an IFM to pay for the expenses associated with the first prospectus of an open-end mutual fund filed in connection with the conversion of a CEF. This carve-out would codify an exemption which is routinely granted by the CSA in connection with conversions.

8. Dilutive issuances of Securities

We respectfully submit that book value accretion or dilution is not necessarily a relevant measure of value for securityholders of CEFs. The concept of NAV dilution for a CEF with limited redemptions is less relevant than it is for a mutual fund in continuous distribution with daily redemptions at NAV since the CEF investors have very limited access to redemption at NAV. As you are aware, CEFs generally only provide redemptions based on NAV once a year and this annual redemption may be capped by CEFs. For these CEFs, where we believe trading securities on the TSX is the primary liquidity option for investors, the best or most accessible measure of value for a publicly traded entity is its trading market price. It is not unusual for a publicly traded entity to trade below its book value (calculated NAV) and investors are aware of such possibility as we include clear disclosure of this fact in the risk factors included in the prospectus and continuous disclosure of CEFs. We believe the market price of a CEF is influenced not only by the NAV, but

also by other value factors such as yield, liquidity, fees (including the availability of a service fee), performance and the term to maturity. Accordingly, capital raising activities of these CEFs such as warrant offerings, or other follow-on offerings (which may be beneficial to the CEF by increasing the size and lowering the MER of the fund and maintaining/enhancing market liquidity of the securities of the fund) must be evaluated for their positive effects on the trading price of the CEFs securities in addition to their effects on the NAV.

When considering a capital raising event such as a warrant offering or follow-on offering, we believe that it is appropriate for the investment fund manager to perform an internal assessment of the potential dilution to the NAV of units, if any, arising from the proposed offering. These capital raising events are necessary to maintain CEFs, their liquidity and to maintain the MER at a reasonable level, which are all in the best interests of securityholders. We acknowledge that a potential conflict of interest may exist when the investment fund manager makes decisions on capital raising options. Accordingly, capital raising options, including warrant offerings, are discussed in accordance with NI 81-107 with the CEF's IRC in advance. The IRC must then determine whether the proposed offering achieves a fair and reasonable outcome for the CEF before it may proceed.

9. Naming Conventions for Investment Funds

As noted above, it is difficult to comment on the appropriateness of the label “Alternative Fund” without assessing the Alternative Fund Proposal. Nevertheless, it is unclear to us why a new naming convention is required and we are concerned that the term “Alternative Fund” may create a negative connotation with investors and produce additional confusion by grouping different types of funds under one label.

10. Transitional Provisions

We submit that all existing CEFs should be grandfathered from the provisions of proposed NI 81-102 and NI 81-104. Existing funds should continue to be able to conduct their business, operations and affairs in all respects in compliance with their constating or governing documents. In particular, they should continue to be able to issue securities, including warrants, rights and other specified derivatives. We believe that if investors or their advisors wish to move to the new products governed by the new NI 81-102 and NI 81-104 regime, they have the choice to sell or redeem their grandfathered funds and purchase new products.

Requiring a transition period for CEFs is inappropriate as it would create substantial confusion and uncertainty for investors since it is unclear how the transition would impact the relevant fund in terms of costs and ability to continue and possibly compromise their ability to report historical performance. Furthermore, and more importantly, IFMs created and marketed these funds and investors purchased these funds on the basis of their current structure and it is not clear why this agreement should be ignored. It is important that the CSA provide clarity regarding grandfathering as soon as possible as we have concerns that the prevailing uncertainty may have a chilling effect on the CEF market and we do not believe that this is what the CSA intended by the Notice.

Alternative Funds Framework

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 on a fully consultative basis which would expand the truly more “alternative” types of funds that ought to be captured by that definition.

In recognition of the growth of alternative asset classes and strategies, as well as corresponding 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. We are optimistic that this approach may provide opportunities for products suitable for the needs and risk profiles of investors. We recognize that the Alternative Funds Framework is at an early stage of development and, as a result, wish to address issues raised in the Notice only at a high level.

One significant concern we have about the Alternative Funds Framework and whether it will present a viable alternative to the proposed regime for CEFs under NI 81-102 relates to proficiency requirements for individual dealing representatives. We are not aware of existing courses which have been developed for dealing representatives and which would add value to the offering of Alternative Funds. Similarly, we are not aware of specific experience that dealing representatives of investment dealers should be required to have to assist them in evaluating Alternative Funds. In the absence of suitable courses or identifiable experience, we believe that the qualifications of dealing representatives of mutual fund dealers as supplemented by NI 81-104 and those applicable to investment dealers, the highest available qualification, including the supervisory requirements provided in NI 81-104, are adequate.

Conclusion

If you have any questions concerning these comments please contact David D. Valentine (416) 863-2933, Stacy McLean (416) 863-4325 or any other member of the Blakes Investment Products & Asset Management Group.

Sincerely,

"Blake, Cassels & Graydon LLP"