McCarthy Tétrault LLP
Box 48, Suite 5300
Toronto Dominion Bank Tower
Toronto ON M5K 1E6
Canada
Tel: 416-362-1812
Fax: 416-868-0673

Andrew R. Armstrong
Direct Line: 416-601-8310
Email: aarmstro@mccarthy.ca

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
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, QC H4Z 1G3

Dear Sirs and Mesdames:

RE: CSA Notice and Request for Comments

We are pleased to provide comments in response to the proposed amendments (the "**Proposed Amendments**") outlined in the CSA Notice and Request for Comment published on March 27, 2013 (the "**Notice**") concerning Phase 2 of the CSA's modernization of investment fund product regulation (the "**Modernization Project**").

We also reference 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 National Instrument 81-102 ("**NI 81-102**") in respect of which immediate comment was being requested. As a result of the Extension Notice, we have provided more extensive comments on those of the Proposed Amendments identified in the Extension Notice on the basis that there will be an opportunity in the future to provide further input on the other Proposed Amendments.

General Comments

We are supportive of a number of the initiatives proposed by the CSA related to operational requirements which promote investor protection. However, we have concerns with respect to the potential impact of certain of the Proposed Amendments related to investment restrictions and the payment of organizational expenses. In particular, we are concerned that the changes proposed by the CSA in these areas will have a negative impact on the closed end fund ("**CEF**") industry as a whole and may have the unintended consequence of reducing the appeal, and therefore the size, of the CEF market.

We believe that the baseline investor protections which the CSA proposes to adopt make sense from an investor protection standpoint and in most cases are already provided for in the constating documents of CEFs. Accordingly, we support the Proposed Amendments of the CSA as they relate to:

1. conflicts of interest provisions (Part 4 of NI 81-102);

2. securityholder and regulatory approval requirements for fundamental changes to non-redeemable investment funds and their management (Part 5 of NI 81-102);

3. custodianship requirements (Part 6 of NI 81-102);

4. sales and redemptions of securities of non-redeemable investment funds (Parts 9 and 10 and proposed Part 9.1 of NI 81-102);

5. commingling of cash relating to sales and redemptions of non-redeemable investment fund securities (Part 11 of NI 81-102);

6. record date requirements (Part 14 of NI 81-102);

7. sales communications parameters (Part 15 of NI 81-102); and

8. securityholder record requirements (Part 18 of NI 81-102).

CEFs are meant to provide investors with an alternative to mutual funds and are different than mutual funds in certain key respects. In the Notice, the CSA makes reference to certain similarities and differences between mutual funds and non-redeemable investment funds. While certain differences were highlighted, it is also worth noting a number of other differences between CEFs and mutual funds, including:

1. The securities of each CEF are qualified by a detailed long-form prospectus rather than a simplified prospectus which is very generic and seeks to provide disclosure on numerous mutual funds;

2. CEFs are only distributed through IIROC regulated dealers;

3. CEFs are typically TSX listed whereas mutual funds are not; and

4. CEFs are created together with independent investment dealers who perform significant due diligence on each product including engaging (in almost all cases) separate legal counsel. In contrast, mutual funds are typically created by the investment fund manager

together with its legal counsel without any independent third party due diligence or structuring.

We do not believe the differences between CEFs and mutual funds were adequately considered by the CSA in developing the Proposed Amendments. In particular, we submit that the involvement of investment dealers has an important impact on how CEFs are created. Independent investment dealers are actively engaged in each individual product to ensure that the investment restrictions created for a CEF are appropriate for the strategy and asset class in which the portfolio manager proposes to invest. We believe this is a more appropriate approach than creating a generic set of investment restrictions that effectively creates a "one size fits all" approach to investing.

In the Notice, certain specific objectives for Phase 2 were identified including ". . . to identify and address market efficiency, investor protection or fairness issues arising from different regulatory regimes that apply to different types of public offered funds" and "reduce potential for regulatory arbitrage that may exist within the existing framework". In this context, one of the stated goals of the CSA in the Proposed Amendments is to create a "level playing field". We believe that the goal of creating a "level playing field" is based on an incorrect premise. There already is a level playing field in that investment fund managers are able to create and sell all types of investment funds including CEFs, ETFs and mutual funds. If, as seems to be implied by the desire to "level the playing field", CEFs had a significant advantage over other investment funds including mutual funds presumably the large mutual fund companies would create more CEFs and fewer mutual funds. However, we know that not to be the case. In addition, some of the largest mutual fund companies in Canada have created CEFs which are complimentary to their mutual fund platforms. Accordingly, it is not clear what the CSA is referring to when it proposes that the playing field needs to levelled in some manner. We submit that the investor protection element is dealt with by the proposed operational amendments and the system is fair in that all investment fund managers have access to create each type of investment fund. As for market efficiency, one of the key elements is to provide investors with a range of available products that are not identical and the Proposed Amendments related to investment restrictions would appear to be contrary to this principle.

From a process perspective, the CSA makes reference in the Notice to a cost/benefit analysis, however, no such cost/benefit analysis seems to have been undertaken. This would appear to be contrary to the OSC's Statement of Priorities released on April 4, 2013 which included the following priority for 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". We note that in addition to not providing a cost/benefit analysis there does not appear to be any use of data and analytical approaches as no evidence of problems stemming from the current regime have been identified in the Notice. We are concerned that if adopted as proposed, the effect of the Proposed Amendments will be to deny investor choice and impair market efficiency by putting CEFs at a competitive disadvantage.

Specific Comments

In addition, you have asked for specific feedback with respect to certain questions in Appendix A to the Notice and the numbers and headings below correspond to your questions in the Appendix to the extent we have feedback to provide.

1. ***Annual Redemptions of Securities Based on NAV***

We do not believe that the CSA should reconsider its present view and consider an investment fund to be a mutual fund if it offers any redemptions based on NAV. The annual redemption at NAV feature most CEFs include serves an important purpose as it helps to support the trading price of units of CEFs as investors know that at least annually they can receive the NAV per unit for their investment. Accordingly, most CEFs in Canada trade near their NAV, whereas in the United States where such NAV redemptions are not typically part of a CEF, most funds trade at a more substantial discount to NAV. We believe that the CSA is correct in not applying many of the provisions in Part 10 of NI 81-102 to non-redeemable investment funds as a result of the difference in redemption models between CEFs and mutual funds. We are of the view that a regime which does not permit CEFs to provide for redemptions at NAV at least once per year could have a significant negative impact on the trading price of securities of CEFs and therefore potentially harm investors whose primary means of gaining liquidity is still expected to be through trading on an exchange.

Investment Restrictions

The following comment applies to all of the questions regarding proposed investment restrictions. It is difficult to provide thoughtful commentary on the proposed investment restrictions without understanding in detail the alternative funds framework proposed for NI 81-104 and, accordingly, we do not believe that the CSA should proceed with any of the proposed investment restriction changes without first consulting with the CEF industry and providing sufficient detail as to what will be included in NI 81-104 and better defining how it will interact with NI 81-102. In addition, it is worth noting that investment restrictions for CEFs are created for each specific investment strategy and asset class and this process which involves the investment fund manager, the dealers and their respective lawyers does not appear to have created any issues identified in the Notice. The investment restrictions are clearly disclosed in the prospectus of each CEF and we believe that disclosure is a better approach than a rules based approach which by its nature will be less flexible.

2. ***Concentration Restriction***

While we agree with the CSA that a 10% concentration limit is typical in the majority of CEFs, we do not believe that it is necessary to codify 10% as an absolute limit. CEFs are not meant to provide investors with a complete investment solution and therefore creating a limit of 10% does not seem appropriate. We would suggest a limit in the range of 20% together with a broader fixed portfolio exemption than is currently contemplated. In particular, any proposed CEF that by its investment strategy has a "rules based" or formulaic approach to investing should be exempt from the concentration restriction including with respect to any rebalancing or portfolio substitutions.

3. ***Investments in Illiquid Assets***

As CEFs do not have the same liquidity requirements with respect to funding ongoing redemptions as mutual funds, we think it is appropriate that they have the ability to hold larger amounts of illiquid assets. The fact that CEFs at most have a NAV redemption annually means that their need for liquidity is significantly less than that of a mutual fund. In addition, in circumstances where a CEF is investing in a less liquid asset, the amount of notice required to be given in connection with the annual NAV redemption is often extended to take this fact into account. This is an example of the consultative approach between the investment dealers and

investment fund manager working together to identify appropriate structural features based on the asset class of the applicable CEF.

In addition, we believe that the definition of illiquid asset in NI 81-102 as currently drafted does not reflect the current reality of the market (either for CEFs or mutual funds) and would suggest that prior to the CSA imposing a new illiquid asset restriction on CEFs that this definition be updated or, at the very least, clarified. Specifically, the reference to ". . . through market facilities on which public quotations in common use are widely available . . ." raises the question as to whether asset classes such as senior loans and/or high yield bonds would technically be deemed to be an "illiquid asset" in spite of the fact that there are deep and liquid markets for both of these asset classes.

4. ***Borrowing***

We are not aware of any evidence that would provide support for the proposition that the lender being a "Canadian financial institution" would "provide additional monitoring and controls over non-redeemable investment funds cash borrowings that are based on the investment strategies and financial conditions of the specific fund".

We do not feel that it is appropriate for the CSA to prescribe limits on leverage. Different strategies and different asset classes lead to different levels of appropriate leverage and we submit that the current approach where leverage is determined on a consultative basis between investment fund managers and investment dealers is appropriate. From being involved in the creation of numerous CEFs, we can confirm that the amount and type of leverage to be employed by a specific CEF is a topic that is negotiated between the investment dealers and the investment fund managers in the development stage of a CEF and is carefully thought through depending upon the asset class and investment strategy. The use of leverage, limits thereon and risks associated with the use of leverage can all be dealt with through disclosure rather than creating an arbitrary limit.

In addition, we note that if the limit proposed by the CSA were to be imposed upon existing funds, a significant number of such funds would be immediately offside. Accordingly, to the extent that the CSA comes to the conclusion that such a limit is absolutely necessary, we would urge the CSA to revisit the 30% limit and move it to a higher number that more accurately reflects the current CEF market.

5. ***Investments in Mortgages***

MICS

The CSA has specifically asked for comment on the impact of the proposed restriction on investments in non-guaranteed mortgages for publicly offered non-redeemable investment funds. The mortgage investment corporations ("**MICs**") that are currently publicly offered non-redeemable investment funds would, if the CSA proposal is adopted and no grandfathering is permitted, be required to either wind-up or convert to regular corporate issuers. In fact, one investment fund manager has already commenced this process as a result of the Notice. The reason for this is that the MICs that currently exist do not invest in guaranteed mortgages and investments in guaranteed mortgages would not fit within their investment strategies. Accordingly, all of the current MICs that we are aware of that are investment funds would need to transition. In the Notice, the CSA makes the comment that "we have observed that there is currently a limited number of existing publicly offered non-redeemable investment funds that

have investment objectives of investing in non-guaranteed mortgages." What is not expressly stated is that there are no non-redeemable investment funds that we are aware of that have as their investment objective investment in guaranteed mortgages and therefore, as a result, the CSA would be effectively eliminating MICs from the investment fund category.

In the Notice the CSA expresses 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." It is not clear in reading the Notice or CSA Staff Notice 31-323 Guidance Related to the Registration Obligations of Mortgage Investment Entities ("**CSA 31-123**") as to why the CSA is proposing to create a 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, who enters into the mortgage and who administers the mortgage, among other elements. We further note that there is also no guidance on this point in the most recent Investment Funds Practitioner (May 2013) which also deals with MICs. We are not aware of a distinction between non-guaranteed mortgages and guaranteed mortgages and how such a portfolio would be managed and therefore believe that the CSA is creating a false distinction. We would be interested to understand the rationale behind this proposal.

The reference to the fact that the CSA believes that non-guaranteed mortgages "may not be appropriate investments for publicly offered investment funds" seems to suggest that the CSA may have some concerns from an investor protection standpoint regarding MICs although we can only guess that this is the issue due to the lack of guidance in the Notice. It is not clear how a transition to the regulatory regime for issuers that are not investment funds would alleviate any concerns regarding investor protection. In addition, one could argue that certain of the benefits of an investment fund, including redemptions, the publication of a net asset value, the imposition of investment restrictions and the fact that an investment fund has a registered investment fund manager, would be lost if there was a transition of MICs to the corporate finance branch.

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 with respect to financial statement disclosure. Accordingly, the approach of the CSA may in fact have the impact of creating 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 statements 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.

If it is in fact the goal of the CSA to remove MICs from the category of non-redeemable investment fund (which would effectively be the result if the proposed restriction is adopted) then a transition period of 24 months would likely be sufficient as we do not see a circumstance where any existing MICs would conform their investment objectives and strategies in order to continue to qualify as an investment fund. However, if the new regime for MICs in adopted by the CSA, we believe that it would be more appropriate to grandfather existing funds. The existing MICs which were created as investment funds currently report in the same manner as other investment funds and it is on this basis that they were sold to investors and therefore we believe that it would be more confusing to investors to change the approach taken mid-stream. In addition, there would be costs associated with such a transition including, without limitation,

the costs associated with holding a shareholder meeting and the costs associated with amending the MICs constating and other documents to reflect the change in approach. We do not see a significant fairness issue in not requiring existing investment fund MICs to undergo the expense and time of converting as investors bought these MICs on the basis and understanding that they were investment funds. In fact, one could argue that the MICs that are investment funds would in fact be at a disadvantage from the perspective of certain standard features included in such MICs including providing for redemptions and the requirement that they have a registered investment fund manager.

6. ***Fund-of-Fund Structures***

With the recent changes to tax legislation regarding character conversion transactions, we expect that the number and frequency of fund-of-fund structures is likely to diminish significantly. Nonetheless, we believe that fund-of-fund structures should be allowed subject to a "look through" on investment restrictions including effective leverage and other relevant investment restrictions. Provided that the overall structure complies with the investment restrictions provided for in the constating documents or NI 81-102, as applicable, we do not see a policy rationale for limiting fund-of-fund structures.

We do not feel that it is necessary for an underlying fund to be a reporting issuer in all the jurisdictions in which the top fund is a reporting issuer provided the underlying fund does not offer securities in a jurisdiction in which it is not a reporting issuer. We note that with SEDAR, provided that an underlying fund is a reporting issuer in one jurisdiction the documentation with respect to the underlying fund would be available to the public should they wish to access it. In addition, we note that the top fund is required to provide full, true and plain disclosure in its prospectus which by implication would include disclosure about the underlying fund and accordingly it is not necessary to require delivery of a bottom fund prospectus to top fund investors.

7. ***Organizational Costs of New Non-Redeemable Investment Funds***

We believe that the proposal to require managers to pay the organizational costs of CEFs does not adequately recognize the differences between the launch of a CEF and a mutual fund. CEFs are launched on a one time basis with a long form prospectus on Form 41-101F2 and the process involves two sets of counsel, auditors and investment dealers, whereas adding a new class to a simplified prospectus is a much simpler and less expensive process. A CEF typically offers its securities to the public once and therefore requiring the CEF to pay the costs associated with such an offering is not prejudicial as it is in the mutual fund context where the initial investors would disproportionately pay such expenses. We do not believe that it is appropriate for the CSA to get involved in pricing related matters which it would be doing if it were to require the investment fund manager to pick up the organizational costs of creating a CEF. We would expect that in the event that such an amendment was adopted the likely result would be an increase in management fees charged to investors in order to allow investment fund managers to recoup the organizational costs over a period of time. Accordingly, in the long run, we would expect a long term investor in a CEF to be worse off from a cost perspective. In addition, there is also the possibility that certain other terms of such offerings would need to change to reflect the increased payment required by the investment fund manager. One such change that would be foreseeable is to extend the date for the first annual redemption to further in the future and perhaps provide further limits on such redemptions.

We are aware of others providing you with sample budgets for a CEF offering and wish to reiterate that as illustrated by such examples only a small fraction of such expenses are discretionary and the majority are required by regulatory requirements.

The Notice also suggests that requiring the investment fund manager to bear offering costs will enhance the efficiency of CEF offerings. We note that to the extent there is a failed deal the investment fund manager pays the costs and therefore investment fund managers already have a strong incentive to minimize costs. In addition, market practice has evolved such that offering costs are limited to 1.5% of gross proceeds raised on a CEF offering which also aligns the interest of the investment fund manager and investors. This market convention was adopted by the investment dealers as a fair allocation of costs and we would be supportive of such a limit being codified if the CSA is intent on regulating organizational expense.

8. ***Naming Convention for Investment Funds***

We do not think it is appropriate to create any naming convention unless a broader range of alternatives is provided. To simply name something an "alternative fund" would not necessarily be descriptive of the fund being offered. Without knowing in detail what is proposed for the alternative funds framework, it is difficult to make a determination as to what would properly fit within this category and it may well be that because of certain investment restrictions, certain plain vanilla type strategies (that have less "risk" than a fund governed by NI 81-102) might nonetheless find themselves in the new NI 81-104 and, accordingly, to deem all such funds "alternative funds" may have a chilling effect.

9. ***Transition Period of the Proposed Amendments and Implementing the Alternative Funds Framework***

We do not believe that a transition period is appropriate and that funds that are in existence prior to the coming-into-force date of the Proposed Amendments should be grandfathered from the investment restriction changes. The rationale for this is that existing funds at that time will have been sold on a specific basis to investors and investors will expect that they have the benefit of the investment strategy that was sold to them when they acquired the applicable fund. If funds are required to transition, the impact would be to effectively substitute the CSA's views as to appropriate portfolio management strategies for those of the portfolio managers who created the fund and we do not feel that that would be appropriate. In the event that the CSA determines that the transition period is the preferred approach rather than grandfathering, we would propose that such transition period should not commence until such time as NI 81-104 is in place.

10. ***Anticipated Costs of the Proposed Amendments and Implementing the Alternative Funds Framework***

We certainly see the benefits with respect to the imposition of the core operational requirements in the Proposed Amendments as they promote the CSA's goal of investor protection. However, as indicated above, it is not clear to us what benefits the Proposed Amendments provide with respect to the imposition of certain investment restrictions. In particular, it is not clear what harm the CSA is trying to rectify in imposing the investment restrictions and therefore, it is difficult to provide commentary with respect to the benefits unless the goal is to homogenize the investment landscape. We would respectfully submit that the costs will include more limited investor choice with respect to unique investment products, potentially increasing costs to investors if the organizational costs amendment is followed and potentially decreasing the

number of CEFs and CEF issuers if creating a CEF is perceived to be less appealing as a result of the Proposed Amendments.

* * * * * * * * *

We are not aware of CSA Staff consulting with the CEF industry prior to issuing the Notice other than by issuing Staff Notice 81-322 ("**Notice 81-322**"), however, the issues dealt with in the Notice are much more extensive than what had been described in Staff Notice 81-322. Accordingly, prior to implementing changes with respect to investment restrictions, the alternative funds framework and organizational expenses we believe it would be beneficial for the CSA to consult with industry participants in a meaningful way. One recent example of such consultation was in respect of mutual fund fees where the CSA first published a Discussion Paper followed by an open roundtable on the issue prior to issuing draft legislation.

Thank you for the opportunity to comment on the Proposed Amendments. We would be happy to discuss any of the above with you further. If you have any questions, please do not hesitate to contact Andrew Armstrong (Toronto), Sean Sadler (Toronto), Michael Nicholas (Toronto) or Sonia Struthers (Montreal).

Yours truly,

McCarthy Tétrault LLP

(Signed) "Andrew Armstrong"

Andrew R. Armstrong

AA/kt