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BY ELECTRONIC MAIL

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

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
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Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment -
Modernization of Investment Fund Product Regulation – Alternative Funds

We are counsel to GrowthWorks Capital Ltd. ("GWC") which is the manager or portfolio manager of certain labour-sponsored investment funds ("LSIFs") including the Working Opportunity Fund (EVCC) Ltd. ("WOF") and GrowthWorks Atlantic Venture Fund Ltd. ("AVF").

We are writing on behalf of GWC to provide comments on Proposed Amendments (as defined in the above referenced CSA Notice and Request for Comment). Our client appreciates the opportunity to provide input on this regulatory process.

BACKGROUND

GWC is registered as a portfolio manager under securities laws in the provinces of Nova Scotia, Ontario, Manitoba, Saskatchewan and British Columbia, a mutual fund dealer under securities laws in the provinces of Nova Scotia, Ontario, Saskatchewan and British Columbia, an exempt market dealer under securities laws in the provinces of British Columbia and Ontario and an investment fund manager in British Columbia.

WOF is an employee venture capital corporation ("EVCC") registered under the *Employee Investment Act* (British Columbia) and is a prescribed labour sponsored venture capital corporation under the *Income Tax Act* (Canada).

AVF is registered as a labour-sponsored venture-capital corporation under the *Income Tax Act* (Canada), the *Equity Tax Credit Act* (Nova Scotia) and the *Labour-Sponsored Venture Capital Tax Credit Act* (Newfoundland and Labrador) and is a prescribed registered labour-sponsored venture capital corporation under the *New Brunswick Income Tax Act*.

Created as special investment vehicles to encourage greater risk capital investment in small and medium size businesses to foster new business formation and stimulate economic development, LSIFs operate in a qualitatively different environment than other investment funds. As with previous comments on proposed legislation and exemptive relief applications, we believe it is important to highlight the following critical differences between LSIFs and other more traditional investment funds:

- *The Goal of the LSIF Program* - In the late 1980's and early 1990's, the federal government and the governments of Ontario and British Columbia recognized that traditional capital markets were not providing sufficient venture capital for small and medium sized (mostly private) businesses in Canada. The LSIF program was created as a special investment vehicle to encourage greater risk capital investment in small and medium size businesses to fill this void and foster new business formation and stimulate economic development. The program has been successful in targeting investor capital into small and medium size businesses that has not been matched by traditional mutual funds in Canada. In the 2016 budget, the federal government recognized the continuing importance of the this program by reinstating the federal tax credit for LSIFs registered in provinces that have LSIF programs such as British Columbia, Nova Scotia, New Brunswick and Newfoundland and Labrador.

- *Nature of Venture Capital Investing* - Venture investing can best be described as active, value-added investing of patient capital. A typical venture investment takes 3 to 10 years to mature, during which time the fund's investment manager is actively involved in assisting the investee company to grow and develop, usually by participating at the board level and in sourcing additional financing. Typically, a venture investor will take a significant minority

interest in the investment, often more than 10%. This type of investing is markedly different than more traditional mutual fund investing. Mutual fund investments generally can be characterized as shorter term, passive investing without a significant stake in the companies in which the mutual fund invests and without board representation. Long-term investing requires access to long term capital, which has been recognized by LSIF governing legislation which requires investors to repay both the federal and provincial tax credits if they sell their LSIF shares prior to eight years.

- *Type of Investee Companies* - Labour-sponsored venture capital corporations like WOF and AVF are subject to detailed requirements on the kind of investments that they may make. Under these requirements, LSIFs are required to invest the majority (typically 60-80%) of the capital it has raised in eligible small and medium sized businesses that are typically not public companies. If these investment requirements are not met, LSIFs face potential penalties/taxes. Venture capital investments are typically minority positions in private companies which are not immediately saleable and it takes some time for exit opportunities to arise. Because of this, forced sales of venture investments prior to exit opportunities arising generally result in exit values that are significantly lower than prevailing carrying values, which in turn, result in portfolio losses. This means that venture capital funds like WOF and AVF rely to a significant extent on favourable merger and acquisition and initial public offering market conditions for full value, cash generating exit events, conditions over which they have no control.

- *Valuation of Investee Companies* Venture investments are typically in "emerging private companies" meaning they do not have profits or positive cashflows - they do not have listed prices and are not amenable to conventional valuation methods. As such, WOF and AVF, like most LSIFs, have adopted detailed valuation rules that are consistent with the Canadian Venture Capital and Private Equity Association (CVCA) Valuation Principles and Guidelines to value their venture investments. The carrying values generated are reviewed annually by an independent chartered business valuator. Under these rules, venture investments are valued at estimated fair value being the price that would be received to sell an investment in an orderly transaction between arm's length market participants at the valuation date using the method of valuation which best and most objectively reflects such fair value. Typically investments are valued at cost for the first year, and thereafter, based on valuation events such as a recent significant arm's length, bona fide, enforceable offer or transaction. Valuation events may result in a particular investee company making up a significantly larger proportion of a fund's net asset value ("NAV") and this impact may be magnified in situations where a fund is pursuing divestments as part of an orderly realization of value.

- *Adverse Consequences of not participating in Follow-on Financings* - Follow-on investing is a key element of the venture investment cycle. Typically a fund does not provide initial funding that will support the portfolio company throughout the investee company's entire development cycle. Often multiple rounds of follow-on financing are completed at different stages of the company's development before a company is generating income to finance its own operations or until an exit opportunity arises. If any investor, including a LSIF, does not participate in follow-on rounds of financing, either by choice or due to investment restrictions, the investor faces a number of negative consequences, including:
    - having its investment significantly diluted if the follow-on round is completed at a lower price than prior rounds;
    - incurring "play or pay" penalties whereby syndicate members that do not participate in follow-on rounds of financing are penalized through, for example, the loss of anti-dilution rights, the loss of board seats or forced conversion of preferred shares into lower-ranking classes of shares; and
    - losing the value of the investment entirely if the portfolio company cannot secure needed financing from alternative sources.

These above noted fundamental differences have been recognized by securities regulators in three specific ways:

(1) in the form of orders that exempt LSIFs from many of the investment restrictions that were formulated with conventional mutual funds in mind;

(2) in the form of an express conflicts provision within NI 81-102 as set out in section 1.2(4) which expressly states that to the extent a provision of NI 81-102 conflicts with or is inconsistent with a provision of the EIA or the *Small Business Venture Capital Act* (British Columbia), the provision of the EIA or the *Small Business Venture Capital Act*, as the case may be, prevails; and

(3) by way of regulation of a specific commission such as regulation 240 of the Ontario Regulation expressly exempts LSIFs from the requirements of a rule, policy or practice of the Ontario Securities Commission that conflicts with a provision of the *Labour Sponsored Venture Capital Corporations Act*, 1992 [now the *Community Small Business Investment Funds Act*].

We submit that this special context of LSIFs should be duly considered when forming securities regulatory policy applicable to these particular funds. This may mean in some instances that a "one size fits all" approach will not be appropriate.

COMMENTS ON THE PROPOSED AMENDMENTS

We have limited our comments to items most relevant to LSIFs and as such have provided select comments on the Proposed Amendments as set out below.

Status of Current Exemptive Relief

We seek clarification on behalf of GWC as to the status of currently existing exemptive relief for LSIFs.

In this regard, we note that AVF, like most other LSIFs, has received exemptive relief from a number of sections of NI 81-102 as follows: from sections 2.2, 2.3(g), 2.4, 2.6(d) and (f), 4.2(1)4, 5.5(1)(d), 7.1, 10.2(5), 10.3 and 10.4(1) of NI 81-102 pursuant to decision letter dated January 7, 2005 of the Nova Scotia Securities Commission ("NSSC"); from sections 2.1, 2.6(a) and (h) of NI 81-102 pursuant to decision document of the NSSC dated March 2, 2009; and from sections 7.1 and 5.5(1)(d), both revised from the 2005 relief, pursuant to decision document of the NSSC dated December 24, 2015.

We note that the LSIF regulatory environment in which AVF operates as an LSIF that necessitated AVF seek the exemptive relief in the first place has not changed. Requiring LSIFs like AVF to seek additional relief under the Proposed Amendments for exactly the same reasons as previously granted relief would result in unnecessary cost to the fund, which costs are ultimately borne by its shareholders, without a tangible benefit. As such, we respectfully submit that relief previously granted to LSIFs such as AVF should be grandfathered under any proposed changes to NI 81-102.

Notwithstanding our submission regarding the grandfathering of previously granted exemptive relief, we seek confirmation on two matters of interpretation with respect to such previously granted relief.

The first matter we seek confirmation on as a matter of interpretation is the impact of the introduction of a subsection when a fund has been granted exemptive relief from the section generally. For example, as noted above AVF has been granted exemptive relief to section 2.1 with no reference to one or more particular subsections. It would seem that the relief would apply to section 2.1 in its entirety including any subsection of 2.1 subsequently introduced such as proposed subsections 2.1 (1.1).

The second matter we seek confirmation on as a matter of interpretation is with respect to agreements with third parties that have been entered into based on exemptive relief for a particular subsection when a new subsection is proposed that the previously entered into agreement does not comply with. We seek confirmation that such a proposed subsection would be applied by the CSA on a go forward basis, and therefore a fund would not be viewed as being in non-compliance with it for previously entered into agreements or actions.

Section 2.1 Concentration

The Proposed Amendments include a new section 2.1(1.1) that applies specifically to non-redeemable investment funds and alternative funds. The CSA has also identified the following specific issue for comment with respect to section 2.1(1.1) of NI 81-102 requested that:

3. We are proposing to raise the concentration limit for alternative funds to 20% of NAV at the time of purchase, meaning the limit must be observed only at the time of purchasing additional securities of an issuer. Should we also consider introducing an absolute upper limit or "hard cap" on concentration, which would require a fund to begin divesting its holdings of an issuer if the hard cap is breached, even passively, which is similar to the approach taken with illiquid assets under NI 81-102? Please explain why or why not.

As noted above, AVF has been granted exemptive relief to section 2.1 with no reference to one or more particular subsections. It would seem that the relief would apply to section 2.1 in its entirety including any subsection of 2.1 subsequently introduced.

In the alternative, we submit that LSIFs such as AVF should not be subject to proposed section 2.1(1.1) either by way of grandfathering of previous exemption from section 2.1(1) or by express recognition in NI 81-102 because of the critical differences between LSIFs and other more traditional investment funds described above in *Background*.

AVF received exemptive relief in 2009 from the provisions of 2.1 based on the need to allow it to complete follow-on investments in investee companies to extend the timeframe for exit opportunities to arise so that AVF could pursue liquidating its investment positions as part of full value exits. These same reasons exist today and are even more relevant for AVF as it seeks to maximize the potential value of the existing portfolio and distribute cash to shareholders as part of an orderly realization of value under the Pro Rata Redemption Plan ratified by shareholders in 2016. Valuation events that occur from time to time may result in a particular investee company making up a significantly larger proportion of a fund's NAV and this impact is magnified in situations where a fund is pursuing divestments as part of an orderly realization of value. As noted above, if a LSIF does not participate in follow-on rounds of financing, either by choice or due to investment restrictions, then the LSIF faces a number of punitive consequences. As such, defensive follow-ons are important to preserve and potentially add value in any venture portfolio and the need to defend positions in promising companies is even more important when the number of investee companies in a venture portfolio is not expanding. Furthermore, given that venture capital investments are minority positions in private companies which are not immediately saleable and forced sales of venture investments prior to exit opportunities arising generally result in exit values that are <u>significantly</u> lower than prevailing carrying values, we submit enforcing a hard cap on concentration for LSIFs under section 2.1(1.1) would require LSIFs to "fire sell" investments at significantly lower values resulting in considerable adverse consequences for the funds, and therefore for their shareholders.

With respect to WOF, the EIA has a number of specific provisions with respect to concentration of investments (see for example section 16 *Control of Eligible Businesses* and section 19 *Aggregate Investment*) that limit WOF's investment in any particular company. As such, proposed section 2.1 (1.1) would conflict and/or be inconsistent with specific provisions of the EIA which pursuant to section 1.2(4) of NI 81-102 shall prevail. Therefore, we submit that so long as WOF complies with

the restrictions on concentration in the EIA, proposed section 2.1(1.1) would not apply with respect to investments by WOF.

Section 2.4 Illiquid Assets

The Proposed Amendments include new subsections for 2.4 (proposed subsections (4) to (6)) that apply specifically to non-redeemable investment funds. The CSA has also identified the following specific issue for comment with respect to these new subsections and requested that:

6. We are also proposing to cap the amount of illiquid assets held by a non-redeemable investment fund, at 20% of NAV at the time of purchase, with a hard cap of 25% of NAV. We seek feedback on whether this limit is appropriate for most non-redeemable investment funds. In particular, we seek feedback on whether there are any specific types or categories of non-redeemable investment funds, or strategies employed by those funds, that may be particularly impacted by this proposed restriction and what a more appropriate limit, or provisions governing investment in illiquid assets might be in those circumstances. ***In particular, we seek comments relating to non-redeemable investment funds which may, by design or structure, have a significant proportion of illiquid assets, such as 'labour sponsored or venture capital funds' (as that term is defined in NI 81-106) or 'pooled MIEs' (as that term was defined in CSA Staff Notice 31-323 Guidance Relating to the Registration Obligations of Mortgage Investment Entities).***

As noted above, AVF has been granted exemptive relief to section 2.4 with no reference to one or more particular subsections. It would seem that the relief would apply to section 2.4 in its entirety, including any subsection of 2.4 subsequently introduced.

In the alternative, we submit that LSIFs such as AVF should not be subject to proposed subsections 2.4(4) to (6) either by way of grandfathering of previous exemption from section 2.1(1) or by express recognition in the NI 81-102 because of the critical differences between LSIFs and other more traditional investment funds described above in *Background*.

AVF received exemptive relief in 2005 from the provisions of 2.4 because, in order to fulfill the policy initiative behind the LSIF program, AVF was required (and remains required) to invest the majority (typically 60-80%) of its capital in eligible small and medium sized businesses. As such, a very high proportion of AVF's investments would be, and are still today, invested in businesses that do not meet the liquid assets requirements of proposed subsection 2.4(4). If these investment pacing requirements under applicable LSIF legislation are not met, LSIFs face potential penalties/taxes.

These same reasons exist today and are even more relevant for AVF as it seeks to maximize the potential value of the existing portfolio and distribute cash to shareholders as part of an orderly realization of value under the Pro Rata Redemption Plan. The vast majority of AVF's investments are in venture investments which are illiquid. As venture investments are exited, it is expected that AVF will distribute available cash to shareholders under the Pro Rata Redemption Plan thus

maintaining the very high proportion of illiquid investments in the portfolio. Given that venture capital investments are minority positions in private companies which are not immediately saleable and forced sales of venture investments prior to exit opportunities arising generally result in exit values that are significantly lower than prevailing carrying values, we submit enforcing a hard cap on illiquid assets for LSIFs under proposed subsections 2.4 (4) to (6) would require LSIFs like AVF to "fire sell" investments at significantly lower values resulting in considerable adverse consequences for the funds, and therefore, for their shareholders. In addition, the proposed amendments would also have adverse consequences for AVF in terms of restricting follow-on investments. As noted above, if a LSIF does not participate in follow-on rounds of financing, either by choice or due to investment restrictions, then the LSIF faces a number of punitive consequence. As such, defensive follow-ons are important to preserve and potentially add value in any venture portfolio, with the need to defend Atlantic Fund's position in promising companies is even more important given that the number of investee companies in its venture portfolio is not expanding.

With respect to WOF, the EIA has a number of specific provisions that detail the specific types of investments that WOF can and cannot make or hold (see for example section 15 *Eligible Investments* and sections 22 *Permitted Investments*, section 16 *Investments for certain purposes prohibited*, section 17 *Control of Eligible Businesses*, section 18 *non-arm's length investments prohibited*, and section 19 *Aggregate Investment*) and what WOF must do in the event that an investment of WOF's becomes prohibited (see section 20 *Action to be taken if investment becomes* prohibited). As such, proposed subsections 2.4 (4) to (6) would conflict and/or be inconsistent with specific provisions of the EIA which pursuant to section 1.2(4) of NI 81-102 shall prevail. Therefore, we submit that so long as WOF complies with the restrictions on the specific types of investments that WOF can and cannot make or hold under the EIA and what WOF must do in the event that an investment of WOF's becomes prohibited, proposed subsections 2.4(4) to (6) would not apply with respect to investments by WOF.

We appreciate the opportunity to provide our comments on the Proposed Amendments most relevant for LSIFs and welcome the opportunity to discuss them further.

Best regards,

"Jill W. Donaldson"

Jill W. Donaldson

Cc: Derek Lew, President & CEO, GrowthWorks Capital Ltd.