

August 23, 2013

Via 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

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
Montreal (Quebec) H4Z 1G3

Dear Sirs and Madams:

Re: Proposed Modernization of Investment Fund Product Regulation

Strathbridge Asset Management Inc. (“Strathbridge”) is pleased to provide our comments regarding the Modernization of Investment Fund Product Regulation (Phase 2) published on March 27, 2013 and appreciate the extension to the comment period provided on June 25, 2013.

Strathbridge is one of the oldest issuers of closed-end funds (“CEFs”) in Canada, having issued our first (and still operating) fund in 1996. We currently manage 10 TSX listed CEFs and are fully committed to the closed-end structure as we believe it offers many attractive attributes to investors that cannot be achieved using a conventional mutual fund structure.

We typically offer actively managed investment funds that provide sector specific (such as Canadian financial services companies) or theme based portfolios (such as utilities and telecommunication services companies) combined with a covered-call overlay. Our strategies may be more concentrated than a typical mutual fund and our covered call strategy, which typically utilizes 30-day calls, is best suited for a closed-end structure where daily redemptions would be problematic, increasing cash drag and hindering performance.

General Comments

While there are some similarities between conventional mutual funds and CEFs, such as the primary purpose of investing money on behalf of investors and the benefits of pooled investment and portfolio management services to the public, we do not believe these similarities are sufficient to warrant significant policy amendments effectively making both investment vehicles the same. Of primary difference is the targeted investor for these investments. Conventional mutual funds are generally mass marketed to all retail investors and sold by both MFDA registered financial planners and IIROC qualified investment advisors. CEFs on the other hand are more complex investments and only sold by registered IIROC investment advisors to a more sophisticated investor. It is not clear how investors would benefit from a reduction in the scope of investment vehicles available to them.

In principle, we support any proposal that helps provide investors with greater protection and which provides investors greater clarity and the ability to understand the instruments in which they invest. However, it is unclear how “level[ing] the playing field among non-redeemable investment funds, conventional mutual funds and exchange-traded mutual funds” will assist investors in their investment decisions or provide additional investor protection. The “playing field” is already level since investment fund managers are not restricted in the types of funds they can offer to investors. In fact, many fund managers offer CEFs in addition to conventional mutual funds. Firms such as Middlefield, Brompton, First Asset are traditional CEF issuers, but also offer mutual funds while larger conventional mutual fund complexes such as Manulife, CI Funds and Scotiabank all offer closed-end funds as well. It is not the funds which compete with each other, but rather the issuers that compete. Being able to offer a broader array of products using different structures enhances the issuer’s ability to compete and provides investors greater variety of investment strategies from which to choose to suit their specific needs.

That said, we believe some amendments to NI 81-102 are appropriate to continuously upgrade and modernize the investment funds universe. However, consideration of any changes to NI 81-102 without full disclosure of the contemplated changes to NI 81-104 is premature. Issuers must be able to understand the framework in which their funds would operate if not under NI 81-102. Only then can full consideration be given to the proposals for NI 81-102.

Notwithstanding our reservations to commenting on the proposed changes to NI 81-102 without the context of proposed changes and framework for NI 81-104 we offer the following comments on the specific questions posed in Annex A:

1) Annual Redemption of Securities Based on NAV

We believe the annual redemption feature at NAV is a beneficial option for investors. This allows large holders to exit their positions without risking a move in the market price and ensures the trading price remains in close proximity to its NAV per unit. In contrast, the U.S. market does not generally allow for annual redemptions at NAV and consequently U.S. CEFs trade in a much wider range relative to NAV. As the majority of CEFs are book-based they do not maintain records of beneficial holders but rather have one holder, CDS. Any requirement to send investors an annual reminder of redemption procedures must be completed by the dealers. Currently, many of the dealers do send annual reminders of redemption dates to their clients, however, based on some of the calls we receive from panicked clients who believe they must act on the redemption we would urge the use of a standard form that makes it clear to investors that this is an optional right and they are not required to do anything.

2) Concentration Restriction

We are not opposed to codifying a 10% concentration limit in 81-102 funds, however, such a limit must be offset by the ability to offer an 81-104 fund without such a concentration limit. Investment

funds that exceed the 10% concentration limit by virtue of their investment strategy typically disclose such concentration in the offering document in the investment strategy and the risk factors sections. As such, investors are specifically purchasing that fund for the concentrated exposure it provides. Failing the provision of no limit within an 81-104 fund, there does not appear to be any compelling reason to change the concentration limit as long as the level of concentration is fully disclosed to investors.

3) Investment in Illiquid Assets

We support allowing CEFs to invest in illiquid assets and given the typical redemption notice period of approximately one month, a level not exceeding 50% is not unreasonable.

4) Borrowing

One of the primary benefits of the closed-end structure compared to the conventional mutual fund is the ability to use leverage in the portfolio to enhance returns. While the use of leverage changes the risk profile of the fund, this is not inconsistent with providing unique investment opportunities to investors who are seeking such an investment. The issue of leverage is more appropriately addressed as one of disclosure. Are investors aware of the level of leverage in the portfolio? Restricting the ability to add leverage to a portfolio whether through bank borrowing, derivatives or short selling will hinder innovation and reduce the availability of unique investment products for Canadians. In addition, fund managers should have the ability to obtain leverage through multiple jurisdictions as befits the nature of the investments in order to hedge risk and provide the best possible solutions to investors. Any limit to borrowing must be considered in the context of any changes to NI 81-104.

One of the related consequences of the proposed changes to borrowing would be that CEFs would not be permitted to issue debt securities to the public. Though this is not a widely used structure there are instances where debt issuance can form part of the structure and selling features of a fund. Given that any such issuance would be completed under a long form prospectus it is not clear why such a prohibition would benefit investors.

8) Organization Costs of New Non-Redeemable Investment Funds

The proposal for CEF managers to pay the upfront issue costs of establishing a new fund is, we believe, based on incorrect assumptions and conclusions regarding the consequences of a manager paying the upfront fees. Manager and investor interests are already aligned since both parties benefit when the NAV per unit rises, investors achieve a greater return on their investment and management fees increase, while the opposite is true if the NAV declines. Having the Manager pay the upfront fees only serves to limit potential new issuers from entering the market which may hinder innovation and stifle capital markets. Ultimately the payment of upfront fees by the manager will have the effect of increasing the MER since these fees plus any financing cost must ultimately be recovered by the manager. Managers are already highly motivated to ensure funds are sustainable in the long term and that fees are kept low since they are at risk for all of the fees if the transaction fails to reach a minimum deal size of \$20 million or a portion of the fees for smaller funds since the dealers have imposed a limit on upfront costs to 1.5% of gross proceeds. Managers therefore cover a portion of the upfront costs for deals between \$20-40 million. Any instances of regulatory arbitrage or using the CEF model to raise funds to convert into a mutual fund resulting in the manager avoiding the payment of upfront fees could be easily resolved by requiring the manager to reimburse the fund upon conversion to a mutual fund for any fees paid by the fund for a set period. It is interesting to note that in light of the higher costs and potential for a failed or small fund when establishing a CEF compared to a mutual fund, the manager takes on greater risk using this arbitrage approach.

9) Dilutive Issuances of Securities

One of the significant differences between a conventional mutual fund and a CEF is the ability of a conventional mutual fund to raise equity through the issuance of new units on a daily basis. Conversely a CEF raises its assets through an intense 6 week marketing period and then closes sale of units. From that point on the number of units outstanding in a CEF is reduced by annual redemptions and any purchases under the normal course issuer bid. By definition this will increase the MER over time and reduce trading liquidity. In certain circumstances, a CEF may trade at a sufficient premium (typically must be at least 4.5%) to allow for a follow-on offering. Failing that, rights or warrants issues have been the only alternative for fund managers to increase the size of the fund to combat a rising MER or decreased liquidity or provide capital to invest when market opportunities arise. The costs associated with a rights or warrant issue are generally much lower than a new issue and therefore pricing these issues such that they are non-dilutive is more practical than a new issue. Eliminating the ability for managers to offset the decline in outstanding units would adversely affect investors.

10) Naming Convention

It is not clear that adding "Alternative Fund" or "Conventional Fund" to the name of a fund would increase an investor's understanding of the investment product. Within each category of funds there is likely to be such a significant variety of strategies and risk profiles that relying on a naming convention to differentiate funds could be misleading and detrimental to investors. It is more appropriate to focus on full disclosure of investment strategies and investment methodologies to fully inform investors. In that regard, it is more useful to investors in mutual funds to adopt the more fulsome disclosure requirement of a long form prospectus and not to bundle several funds in one simplified prospectus wherein it is often difficult to determine the investment strategy actually being employed by a particular conventional mutual fund.

11) Transition Period

Regardless of the scope of the changes to be enacted, such changes should be made on a prospective basis and all existing funds issued under the current rules should be grandfathered. These products were sold and purchased by investors on the merits of a specific investment strategy which may include a certain amount of leverage or concentration in certain securities. Such fund attributes are fully disclosed in the long-form offering prospectus, reiterated in the annual information form and the annual and semi-annual financial statements. Investors purchased them (on the IPO and on an ongoing basis on the TSX) on the basis of the disclosed terms and strategies. Without grandfathering, many funds would have their investment parameters changed which may adversely affect the pecuniary value or future performance of the fund thereby harming investors.

We welcome the opportunity to discuss these comments and provide further input in to the process. In particular, we look forward to reviewing the proposals for NI 81-104 in detail and believe a consultative process prior to finalizing these proposals would be beneficial.

Regards



David Roode
President, Fund Services