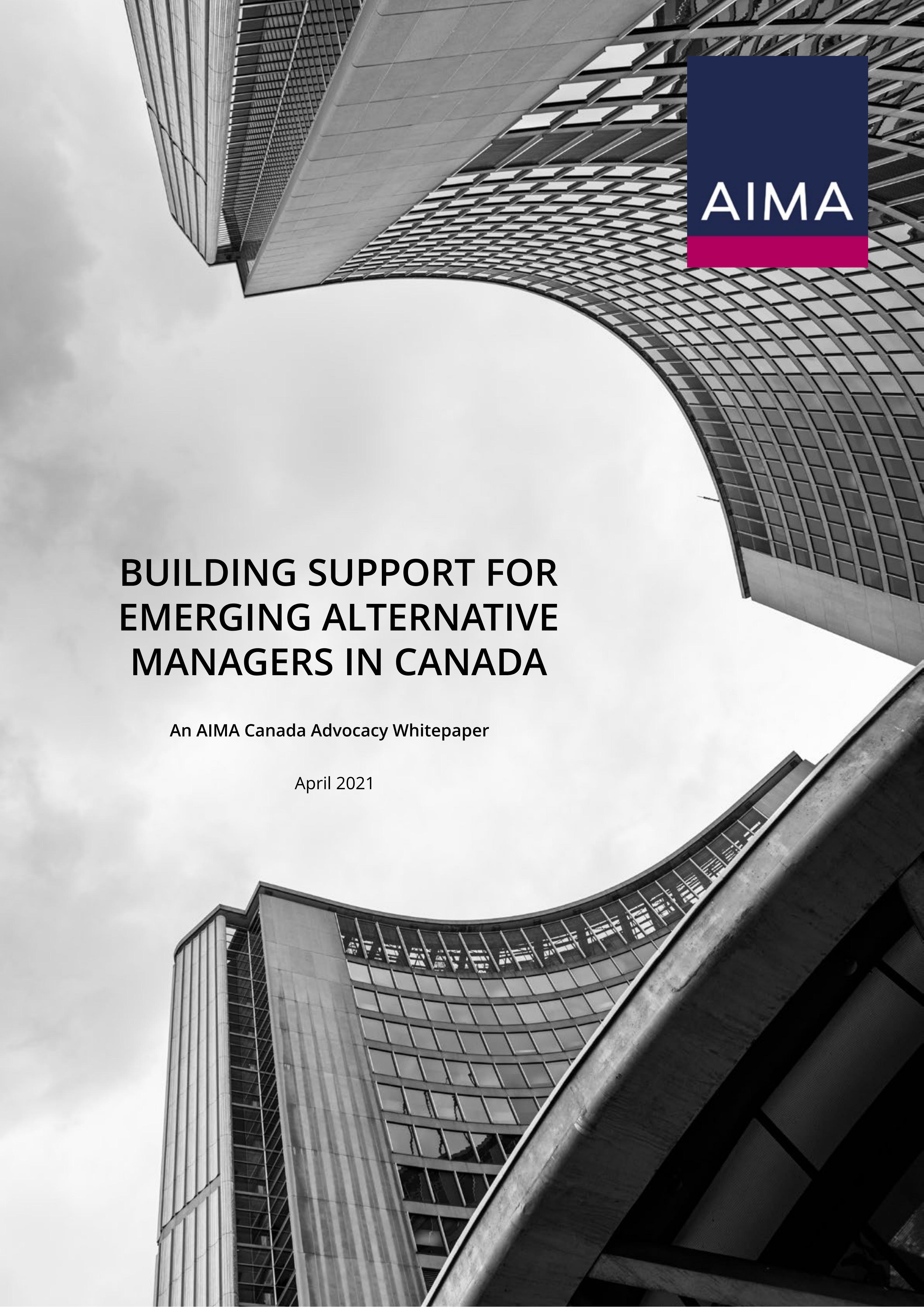

BUILDING SUPPORT FOR EMERGING ALTERNATIVE MANAGERS IN CANADA

An AIMA Canada Advocacy Whitepaper

April 2021

CREATING A WORLD-CLASS ECOSYSTEM FOR CANADIAN EMERGING ALTERNATIVE FUND MANAGERS

EXECUTIVE SUMMARY:

- **Alternative investments are the future in both institutional and retail portfolios**
    - AIMA/HFM research[1] recently indicated 45% of investors intend to increase allocations to hedge funds, 38% intend to increase allocations to private credit, 34% intend to increase allocations to private equity, 32% intend to increase allocations to infrastructure/natural resources and 24% intend to increase allocations to real estate in H1-2021.
    - Many institutional allocators, both in Canada & abroad, are already allocating a significant portion to alternative investments (25-50%+).
- **Canada is home to many talented alternative fund managers**
    - Canadian alternative fund managers have provided diversification, risk reduction and non-correlated returns vs long-only peers and long-only benchmarks through periods of market volatility.
- **Industry trends are increasing pressure and costs of emerging alternative fund managers**
    - There are increased costs to asset management due to the competitive nature of the industry for talent, edge and integration of alternative data, ESG, AI and more into the investment process.
- **Canadian emerging alternative fund managers face real challenges**
    - In comparison to many international peers, Canadian emerging managers often launch at smaller sizes, face more regulatory burden and restricted retail distribution access while not having the benefit of many emerging manager programs.
- **Canada has already built similar ecosystems to foster fintech and tech growth**
    - Promotion of Canada as a fintech leader and providing shared services through the OSC Sandbox, MARS, Finance Montreal and more.
- **Importance of Canada being a leader in alternative investments on the global stage**
    - Amid industry consolidation towards established alternative asset managers, it is important to foster growth of new, diverse and emerging talent at home.

We hope this whitepaper can help initiate discussions with Canadian federal and provincial government representatives, Canadian securities legislators, fellow associations and allocators broadly on how we might best work together to improve support for emerging alternative managers and ensure a robust Canadian alternative investment ecosystem within the global industry for years to come.

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1 AIMA/HFM Investor Intentions H1-2021 https://www.aima.org/educate/aima-research/investor-intentions-h121.html

BENEFITS OF EMERGING MANAGER PROGRAMS

BENEFITS FOR MANAGER	BENEFITS FOR ALLOCATORS
Guidance and mentorship	Lower due diligence costs
Operational efficiencies and shared services	Greater transparency and enhanced governance
Capital allocation and commitments	Stronger relationships with manager
Institutional endorsement	Potentially lower fees and attractive terms
Cost savings	Potential equity stake or revenue-sharing
Overall support, allowing the manager to focus on their competitive advantage of portfolio management.	Attractive risk-return opportunities
FOR GOVERNMENTS & REGULATORS: Quality industry infrastructure facilitating consolidated oversight, job creation, increased competition, economic development and capital formation	
FOR ALL: o Pride and prestige of fostering and supporting exceptional local talent o Ability to invest with specific impact goals (ie. ESG funds, women/minority-owned funds, etc.) o Greater alignment of interests	

EXAMPLES OF EXISTING EMERGING MANAGER PROGRAMS

EMERGING MANAGER PROGRAM	PROVIDES SUPPORT FOR
Quebec Emerging Manager Program	Quebec-based emerging managers
CPP Investments Emerging Manager Program	Emerging managers globally
New York City Retirement Systems and the Comptroller's Office	Emerging managers committed to diversity, including Minority- and Women-owned Business Enterprise (M/WBE)
New York State Comptroller – New York State Common Retirement Fund	Newer, smaller and diverse emerging managers with opportunities for M/WBE
Employees Retirement System of Texas	Emerging managers generally
EFSI Private Credit Programme	Predominantly to diversified debt funds extending senior financing facilities to be extended to SMEs and small mid-caps in the European Union (EU)
IMQubator (former)	Netherlands-based emerging managers
Many fund of hedge funds also support emerging alternative managers (Tages, Man Group, etc.)	

AIMA RECOMMENDATIONS FOR PRACTICAL SOLUTIONS FOR BETTER SUPPORT OF EMERGING ALTERNATIVE MANAGERS IN CANADA

Category	Solution	Description	Cost
Direct Funding	**Capital Funding Pool**	Allocate pool of capital to be distributed to select managers.	$$-$$$
Operations & Technology	**Shareable Databases**	Shared access to financial and non-financial data, including alternative data databases	$$
	Platforms	Shared regulatory and operational platform access for select managers	$$-$$$
	ESG Standards	Shared access to Responsible Investment consultants to integrate ESG at firm and fund levels	$$
Sales & Marketing Support	**Facilitate Canadian Fund of Fund of Emerging Alternative Managers**	Create fund of fund solution to access variety of Canadian managers in one ticket	$-$$
	Due Diligence Review & Consultant: Shared Services	Shared access to proactive due diligence consultant review	$-$$
	Marketing Support: Shared Services	Shared access to marketing consultant and initial designed marketing collateral suite	$
	International Promotion	Global Affairs Canada to lead promotion of Canadian managers in international jurisdictions	$
Talent pipeline	**Student Education, Awareness & Grants**	Promote alternative investment education in universities and provide student grants for CAIA programs	$
Regulatory	**Improve access for retail distribution**	Increase independent product access and reduce hurdles of internal risk ratings and allocation limits	$
	Tax Credits/Refunds	Offer tax refunds for direct spending on these initiatives and for industry association dues	$

FULL REPORT

A SETTING THE STAGE: EMERGING ALTERNATIVE FUND MANAGERS IN CANADA

While alternative mutual funds have begun the democratization of access to these structures to Canadian investors, the alternative investment industry is still in its infancy in Canada. Globally, the alternative investment industry is in a phase of growth, spurred by institutional and retail investors alike due to the need to enhance diverse returns, provide downside protection against volatile markets and deliver non-correlated returns to the broad markets, especially amid continued low interest rate environment. Increasingly, asset allocations are shifting rapidly towards a barbell model of cheap beta (ie. ETFs) supplemented by sophisticated (and inherently more expensive) alpha-generating and risk-reducing alternative investment strategies.

Globally, emerging managers are often defined as asset managers with less than $500M in AUM, though sometimes, that definition is expanded to asset managers with less than $1B in AUM. While there may be an aura of cachet and perception of exclusivity surrounding alternative asset managers, these firms, are often small businesses. In Canada, as of 2018, the average fund size in Canada for alternative asset managers was approximately $35M.[2] Hedge fund assets in Canada sit at approximately $40B USD[3] while Alternative Mutual Funds and Alternative ETF AUM sits at approximately $13B CAD (based on various member calculations). The amended National Instrument 81-102 structure has had a positive benefit both for retail asset flows and retail investor access of alternative investments, though much growth of market share exists for liquid alternatives. Many of Canada's emerging alternative fund managers manage less than $250M. Managers may start with as little as $10M in AUM, with less than ten staff.[4] As they scale, managers may grow to 60 or more employees. Many alternative investment managers directly fund SMEs through private lending, private equity,[5] venture capital and other investment.[6]

In addition to portfolio benefits, alternative asset managers in Canada provide real value to our financial markets and to our real economy. Through short selling, hedge funds and liquid alternatives can provide efficiency to the market with regards to price discovery, price correction and risk mitigation. Through private credit and direct lending, private debt funds provide essential capital to small and mid-sized enterprises, filling a critical gap that public bank lending does not.

The factors driving competition for success in alternative investment management are higher than ever, extending well beyond delivering competitve risk-adjusted returns. Canadian firms compete globally for allocations amid increased asset consolidation towards established alternative asset managers, a growing war for quantitatively-skilled talent, the increasing requirement to integrate ESG & sustainable finance, continually enhanced regulatory requirements in every jurisdiction, the increased need to integrate expensive big data, artificial intelligence (AI)/machine learning (ML) and alternative data to deliver consistent alpha in today's markets and more.

To properly compete in Canada and abroad, emerging alternative asset managers need the support in order to ensure a robust local industry long-term and to ensure that Canadian investors can access resident talent providing downside protection, diversification and non-correlated returns.

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2 Preqin, 2018

3 Preqin, 2020

4 See AIMA research, Alive & Kicking (2017) and Making It Big (2018) on average staffing by AUM.

5 For more information on the impact of private equity and venture capital in Canada, visit www.cvca.ca

6 AIMA & ACC represent hedge fund, liquid alternative and private credit industries, with managers, investors and service providers forming our membership at a corporate level across the globe. Our comments herein will focus on these asset classes.

B CHALLENGES FACING EMERGING & BOUTIQUE ALTERNATIVE ASSET MANAGERS

General Challenges

There are a host of challenges facing emerging alternative asset managers, some that might even be reasonable and common to all managers globally with respect to the time it takes to build a business.

For example, managers might require a minimum of 12-month, 3-year or even 5-year track record before some investor types will consider allocating. There may be minimum AUM requirements, and thus the growth to reaching the first milestones might come from HNW or UHNW (accredited investor) individuals, family friends, family offices and the fund managers as business partners themselves.[7]

Technological Advancement & Thematic Challenges - Global

Alpha generation is becoming incredibly complex, sophisticated and expensive, with the increased use of big data, alternative data, artificial intelligence and ESG. There are only a few centers around the world that will be able to maintain a deep enough cluster of talent/technology/experience/expertise to service the global investor clientele. As these trends become more prominent in our industry, the need to integrate this into portfolio analysis and the investment process becomes a near requirement in order to properly compete with larger, more established firms for alpha and risk-adjusted performance. Alternative data sets, for example, can be expensive (ie. $150,000+ per month) and the complexity of integrating these, or any other artificial intelligence, machine learning and big data requires top-paid talent and customized, expensive portfolio tools.

Canada continues to emerge on the global stage as a leader in fintech and AI and the need to attract and retain talent at home for this industry, and in asset management, is paramount. As investors increasingly demand sustainable finance, additional time, effort and resources also need to be put towards ESG-portfolio integration (often with a consultant or with dedicated talent in-house), which also brings additional reporting and analysis costs.

General Distribution Challenges - International

Often, while fund managers are structured to be able to accept orders internationally, it is costly with both time and money to commit to raising money outside of Canada. Investors value relationships and face-to-face interaction, even in this digital age, and managers would need to commit to extensive business development and travel expense, and/or staffing to grow this channel. Third party marketers and sub-advised relationships have been used by select Canadian firms to some success, though there can be challenges of oversight and priority with these relationships. Stereotypes of the Canadian marketplace that we have too strong a bias to oil, gas, energy and resources, persist with some international investors, who may incorrectly assume Canadian emerging alternative asset managers are only investing in these local sectors. Often, firms seek out guidance on how to best access and educate these international markets through industry association membership, like AIMA, or through expensive consultants, crowded fund databases or competitive capital introduction events.

Distribution Challenges in Canada – Institutional Channel

Canadian pensions have long invested in emerging alternative fund managers and in some cases, have brought talented teams and traders in house. While Canadian pensions sometimes invest in local managers, often their internal talent (strong), size (large), scale (broad) and investment mandates cause allocations to emerging alternative fund managers in other countries. Often, anecdotal feedback to Canadian emerging alternative fund managers is that they are trading their strategy well already in-house and even if there were to be a need for an allocation, the small size of an emerging alternative fund manager would cause a pension allocation (which can be $150M+) to be too large and thus a concentration risk to both parties.

7 AIMA Emerging Manager Research, Alive & Kicking, can be accessed here.

It is important to note that Canadian pensions, the "Maple Revolutionaries"[8], have long been global leaders in asset management, and operate, as they should, with robust governance and investment mandates as true guardians of their constituents' retirement funds and future. We do not seek to tell private and independent pensions how to invest their beneficiaries' money. Leading private pensions should continue to bring exceptional talent in-house and allocate as their investment objectives and fiduciary duties require in external partnerships.

Distribution Challenges in Canada – Retail Channel

In addition to general challenges, it is increasingly difficult for boutique fund manufacturers and emerging alternative fund managers to distribute alternative investment products to retail investment advisors at broker dealer firms. Commonly cited challenges that managers face with retail distribution include the overlay of internal risk ratings at IIROC dealers, which can be unfairly high, making it hard for advisors to allocate; the need to specifically meet various criteria before securing fund approval for platform distribution; dealer recommendation list of funds, additional subscription document, risk acknowledgement and internal dealer paperwork for purchasing offering memorandum funds; the increased use of model portfolios and managed accounts at dealer firms; the lack of current distribution of alternative mutual funds and alternative ETFs at MFDA dealers currently[9] ; the inherent smaller salesforces at emerging alternative managers (often 1-8 people in comparison to large traditional asset managers who may have 40-80+ salespeople people across the country); and the inherent need for more education for advisors and their clients to understand alternative funds. Boutique alternative asset managers often struggle, then, to compete by size (staffing, resources and budget) with large global alternative asset managers and local traditional asset managers in securing investor access and winning allocations, especially amid continued consolidation trends towards larger players. The additional paperwork (subscription document, risk acknowledgement form, additional dealer forms) has long been cited as hindrances to the sales process though e-signatures and e-documentation platforms are easing this burden.

Regulatory Burden - Canada

It is our view that the registration of alternative asset managers, the distribution of both private and public funds and the ongoing obligations of registrants managing and distributing private and public funds, carries a significant regulatory burden in time, money and firm resources, and especially to emerging alternative asset managers. Given the priority of managing investments, compliance, operations, systems, reporting, and other regulatory requirements, distribution is often a piece of the puzzle that firms struggle to fund and focus on generally. This makes it even more difficult for emerging alternative fund managers to focus on what is still a very relationship-focused business across a vast geography with few, but mighty players, who often have more leverage to negotiate with. Many suggestions on how to reduce the regulatory burden for registrants have been summarized through AIMA Canada's comment letters on the subject, available publicly here.

These challenges materially affect a fund manager's ability to access pools of capital in Canada and abroad, and directly impact their ability to grow and scale.

C RECOMMENDATIONS ON HOW EMERGING & BOUTIQUE ALTERNATIVE ASSET MANAGERS CAN BE SUPPORTED IN CANADA

We do believe there is a gap in support and funding of exceptional home-grown industry and talent. Similar emerging alternative fund manager programs (see Appendix) have been built in other jurisdictions, both in Canada and abroad, and have served to foster a supportive ecosystem for emerging alternative asset managers.

8 https://www.economist.com/finance-and-economics/2012/03/03/maple-revolutionaries
9 See AIMA Canada's MFDA Proficiency Requirement Recommendation here.

Canada, broadly, should and needs to be among these global centers investing in diverse, local talent. While we already have a strong and well-developed financial center, it is one that is still concentrated predominantly by the banking sector. Canada is also home to a large base of leading institutional investors who need to have continued access to innovative strategies and exceptional talent to meet their fiduciary obligations. For our significant base of retail investors, it is critical for them to have fair access to independent, alpha-generating and risk-mitigating strategies that would be otherwise less accessible or more expensive if sought outside the jurisdiction.

There are a number of opportunities and solutions that would help boutique and emerging alternative asset managers exist, grow and flourish in Canada. Here are a number of suggestions that would help emerging alternative asset managers grow and graduate to established manager status by helping them overcome some of their most key and costly challenges. Program benefits could be applicable to only a small number of identified alternative asset managers (ie. 10-15) or extended to the entire Canadian alternative asset management industry.

DIRECT FUNDING

a **DIRECT FUNDING FOR IDENTIFIED MANAGER TALENT**: Create a pool of assets that would be allocated to help emerging alternative asset managers scale up successful strategies. Often, emerging alternative fund manager investments can range from $20M to $50M per manager. This infusion of capital would materially support managers' ability to attract further institutional investment and also give further resources to build their business. This is one of the most common features of existing emerging manager programs around the world and often inherently includes mentorship, shared services, reporting support, enhanced due diligence and other benefits as part of the program.

OPERATIONS & TECHNOLOGY

a **SHAREABLE DATABASES:** Developing shareable databases or an online library of financial and non-financial data (including alternative data) to serve the development AI/ML strategies and minimize the cost of access to this data to emerging alternative asset managers. Each manager would scrub, interpret and integrate the baseline data differently based on their strategy and alpha-generation ideas. In Europe, a new Data Governance Act has been recently proposed that would foster the availability of data for use by increasing trust in data intermediaries and by strengthening data-sharing mechanisms across the EU,[10] including data-sharing service providers, data cooperatives and trusted data intermediaries. Further access to shared data would represent a material cost savings to managers, while providing them opportunities to improve their risk-adjusted returns.

b **PLATFORMS:** Developing regulatory and operational platforms that would allow Canadian managers to scale up inside and outside Canadian borders. For example, in the EU, a shared model has been very helpful in providing passporting and potential for expansion on a cross border basis. Innocap, for example, provides support on structuring, customization, on-boarding, risk management, operational oversight, due diligence and ensure independent fund governance. Privium Fund Management, for example, provides start-up support, compliance, regulatory hosting, fund structuring, marketing assistance, investment management oversight, middle office operations and risk management. The Darwin Platform, for example, provides middle office support (client onboarding, asset administration, reporting, relationship management, transactions management and more), risk monitoring and support (counterparty, operational, liquidity, market, credit risks, style drift and more), compliance support (data, accounting and operations) in meeting various regulatory requirements and marketing support. Platforms like these and others with institutional due diligence and infrastructure with multiple alternative asset managers can help encourage large investors to start investing smaller amounts as a result of a trusted platform. This would represent operational efficiencies for managers alongside cost savings and potential for allocations.

10 https://ec.europa.eu/digital-single-market/en/news/proposal-regulation-european-data-governance-data-governance-act

c **ESG STANDARDS:** Developing standards for the alternative asset managers to become global leaders in ESG or sustainable-finance alternative asset management products. The Canadian Investment Fund Standards Committee (CIFSC) is currently exploring ESG category definitions, as is the CFA Institute exploring ESG standards. As allocators increasing demand adherence to specific ESG standards, providing support or democratized access to dedicated ESG consultants would represent a significant cost savings to managers, while providing them opportunities to improve their competitive advantage.

SALES & MARKETING SUPPORT

a **FACILITATE CANADIAN EMERGING ALTERNATIVE MANAGER FUND OF FUNDS:** Facilitate a fund of funds of an identified group of emerging alternative asset managers that can be accessed with one allocation. "When top-performing managers are ready to "graduate" and raise a larger fund, there needs to be some acknowledgement that the Fund of Fund" is "losing a star performer, one who may have contributed an outsized share to the overall composite performance," and so "institutional investors should instead view this as an attribute that supports the investment case for a re-up."[11] This can create a diversified, one-ticket solution for investors looking to allocate across a broad group of emerging alternative asset managers and while having enhanced governance and consolidated oversight of managers within the portfolio.

b **DUE DILIGENCE REVIEW AND INVESTMENT CONSULTANT ENGAGEMENT:** Given the increased use of consultants by institutional allocators, proactively paying for a full-scale due diligence review of select Canadian managers or for promotion by a consultant might assist in attracting allocations from global investors. This would represent proactive cost savings for managers, provide helpful feedback on areas for them to consider improving from a peer perspective and potentially help their fundraising efforts globally.

c **SHARED SERVICES FOR MARKETING SUPPORT:** Often, the costs of building out digital and creative marketing materials is not prioritized by emerging alternative fund managers, who have limited capital, time and resources to dedicate to this. However, building a firm's identity and communicating a firm's story in a concise, compelling and professional manner can be helpful in attracting investors. Contracting a marketing specialist firm to work with identified firms would represent cost savings for managers and assist their capital raising efforts.

d **INTERNATIONAL PROMOTION:** In the past, AIMA Canada was granted funding to work with Global Affairs Canada to put on international introduction events in various jurisdictions, including Australia, Japan and various cities in the USA. These had bifurcated feedback by alternative asset managers participants due to the lack of direct investors or relevant professionals attending, and therefore there was a lack of ROI for these specific visits, though many participants appreciated the effort. If executed properly, there would an opportunity to revisit these types of introduction programs globally (perhaps even virtually) should the right partners commit on the ground in the specific jurisdictions. This would help save alternative asset managers time in strategic networking and assist in their capital raising efforts globally.

TALENT SUPPORT

a **STUDENT AWARENESS AND GRANT PROGRAMS:** It is often up to alternative asset management firms, pensions or industry associations, like AIMA, WCM and others to promote both the alternative investment industry and specific careers in it, which are often lack proper attention in formal course materials for both undergraduate and master programs. A grant program for students to apply for funding to take their CAIA designation (200+ hours of study at approximately $2000-3000 USD for registration, exams fees and study materials) or CAIA Fundamentals (23 hours of programming at

11 https://emergingmanagermonthly.com/2021/01/07/graduation-day/

approximately $850 USD) during their university term or within a set period of time afterwards might encourage further young talent to learn and engage in this space. This would represent cost savings for young adults and decrease some of the burden on industry associations to be the sole source of industry awareness and promotion.

REGULATORY

a **RETAIL DISTRIBUTION BURDEN REDUCTION**: In parallel with the CSA SRO Consultation, it would be worthwhile for the CSA to consider further requirements on fair, fulsome independent product access across IIROC and MFDA dealers. There should be additional governance and consolidated oversight on internal dealer risk ratings, (internal dealer) alternative fund categorization, alternative product allocation limits and internal recommended lists in order to avoid conflict of interest and provide fair access in sufficient size to Canadian retail investors. Finally, removal of burdensome paperwork, like the Risk Acknowledgement form requirement for accredited investors would help remove perceived barriers to investment. These moves would ease and increase distribution opportunities for alternative asset managers.

b **TAX CREDITS/REFUNDS**: Where shared services funding may not be a preferred solution, offer tax refunds to emerging managers on any of the solutions proposed herein, in addition to tax credits for industry association dues to regulatory and educational organizations like AIMA, PMAC and others.

For all of these recommendations, we would expect there to be strict qualifying criteria, stringent due diligence and regular review to ensure any support is fairly allocated to a set number of deserving alternative asset managers. Specific goals, like fostering women-owned or minority-led emerging alternative fund managers, increasing diversity in the industry with minorities through student and young professional grants, or supporting only ESG-focused mandates are also criteria that can be integrated.

Many programs start with 10-15 firms being supported. Selected managers in any type of program benefit not only from the specific services provided, but also in the additional visibility and elevated branding.

D BENEFITS OF PROVIDING EMERGING ALTERNATIVE FUND MANAGER SUPPORT AND WHY CANADA NEEDS TO FOSTER A LEADING ALTERNATIVE INVESTMENT INDUSTRY

There are many benefits to emerging alternative fund manager programs.

For institutional investors, seed money committed for a set period of time can give comfort to potential follow-on investors take comfort that assets are locked in and that there is a "close guiding and monitoring relationship with the manager."[12] This lowers the costs of due diligence and reduces barriers to allocate when managers benefit from existing institutional structure around them, and often results too in lower fees, greater transparency and stronger relationships for allocators. There may also be opportunities to allocate capital and share in the equity of these early-stage firms, a structure that shares the success as the emerging alternative asset manager grows, delivering a venture-capital additional benefit. Emerging alternative asset managers often bring institutional-quality experience with them as they launch their firm and are employee-owned, making them hungry for success though still risk-minded with their own assets. Smaller funds tend to be more nimble and able to take advantage of dislocations in the market more quickly than established, larger mandates."

The payoff isn't about meeting an arbitrary goal, unconnected to the overriding mission of the institution or the fiduciary duties of the officers" – investors also benefit from the diversity of returns coming from

12 https://www.ipe.com/boutique-asset-managers-imqubator-giving-talent-a-push/44611.article

the "next generation of top-quartile performers."[13] Seeding asset management firms like Tages are "firm believers in the benefits of investing with small and emerging managers, which include higher risk- adjusted returns, advantageous terms and greater alignment of interest."[14]

For governments or regulators, there is the benefit of growing quality infrastructure and oversight around exceptional talent with the goal of building a world-class industry. With this, comes the pride and prestige of supporting a local market and promoting it on a global stage.

Finally, for selected managers, there is the benefit not only of the specific services or capital provided, but also in the public prestige and elevated branding as being one of the chosen few. Managers benefit from guidance, shared services, cost savings and fund-raising support, all that can better sustain their business in the present and create the circumstances to propel them to the next tier of success on a local and global stage. Managers benefit from the economies of scale of platforms and programs designed to ensure their focus stays on managing assets and growing the business.

E IN SUMMARY

We do believe there is a gap in support and funding of exceptional home-grown alternative investment talent in Canada. There is an opportunity for Canada to elevate our alternative investment talent on a global stage be sought-after alpha generators and thought leaders, especially amid increasing global competition. But, this path needs to be facilitated with thoughtful and meaningful support, whether that is in shared services, individual funding or further reducing regulatory burden, so that Canadian investment talent can have a fair chance at global success and further support our real economy at home.

13 https://emergingmanagermonthly.com/2021/01/07/graduation-day/

14 https://www.investcorptages.com/seeding-and-hedge-fund-partnerships/

APPENDIX I

EMERGING ALTERNATIVE ASSET MANAGER PROGRAMS IN CANADA AND OTHER JURISDICTIONS

Similar emerging alternative asset manager programs have been built in other jurisdictions, both in Canada and abroad, and have served to foster a supportive ecosystem for these managers. Several are noted with pertinent design and benefit details below.

i. Quebec Emerging Manager Program,[15] Quebec, Canada

Founded in 2016, the Quebec Emerging Manager Program was intended to solve the "incompatibility between institutional investors' needs and emerging firms offering," which "results in a situation of inertia that hinders the development of new asset managers."

Institutional Investors Needs	Emerging Managers Services
• "Finding new sources of return is a must; this is becoming more difficult as the offerings of market participants converge; • Due-diligence reviews are time-consuming and costly; and • Fiduciary risk remains a challenge for the investment process for institutional investors.	• A first institutional mandate is very difficult to obtain; • Building a fund structure and operational framework appealing to institutional investors is burdensome; and • Institutional fund governance and compliance requires in-depth knowledge and expertise."

The introduction of an emerging manager program to the province gives way to several noted advantages:

Advantages for Institutional Investors	Advantages for Emerging Managers
• "Thorough due diligence reviews and careful selection of emerging managers; • Institutional fund structure created and managed by Innocap, reducing operational risks that may be linked to emerging managers; • Allows internal teams to focus on investment functions and to delegate operational, risk, legal and compliance functions to managed accounts experts; and • Participate in the growth and success of new investment strategies from Quebec managers."	• "Acquire important mandates without losing any equity in their firm; • Gain better governance structure and support to ensure firm sustainability; • Allows asset managers to focus on investment activities; and • Obtain the support/recognition of the financial community."

15 All quotes in this section from http://qemp.ca/about-us/

As a result of its efforts "to stimulate financial entrepreneurship in Quebec, in 2016 the Quebec Emerging Managers Program, Innocap and Finance Montréal announced raising about 250 M$ of assets under management, allocated to 7 traditional managers and 3 alternative investment managers."[16] This pool of capital has since been increased to a total of approximately 400 M$ as at February 2021.

ii. CPP Investments Emerging Manager Program

CPPIB's "investment-only mandate ensures we focus solely on maximizing returns and minimizing undue risk to help build a retirement foundation for 20 million Canadians."[17]

In 2016 and 2017, CPPIB "made initial investments of as much as $250 million each in five start-ups and young hedge funds under its Emerging Managers Program in the past two years. While the pension fund has allocated to external hedge funds for almost a decade, it rarely invested in managers with a track record of less than a year before the start of the program in October 2015."[18]

Typical commitments range from "$150 million to $250 million of seed capital each to hedge fund start-ups for two or three years in exchange for a cut of their fee revenue and the ability to invest more later… It also participates in what it calls "acceleration" deals, where it provides a similar amount of money to managers that have typically been operating for fewer than three years and oversee less than $250 million of assets."[19]

iii. The New York City Retirement Systems and the Comptroller's Office,[20] New York, USA

The New York City Retirement Systems and the Comptroller's Office has an Emerging Manager program that is "dedicated to identifying and investing with top performing fund managers that demonstrate exceptional potential and are committed to diversity in their investment decision-making process, ownership structure, compensation, and profit-sharing policies. The Emerging Manager Program seeks to foster the growth and development of successful managers with whom the Systems invest, including Minority- and Women-owned Business Enterprise (M/WBE) fund managers that typically do not have access to large institutional investors."

The program seeks to find significantly experienced investors that can generate competitive risk-adjusted returns and manage funds which may have shorter track records than more established managers. Managers in the USA typically have a higher starting AUM than those in Canada, and hence, a slightly expanded definition of emerging managers.

The criteria for minimum AUM (varying by strategy) includes descriptions such as:

- "Firms that are currently fundraising between $500 million and $2 billion.
- Firms with less than $1 billion in assets under management and/or less than a 3-year track record at time of funding.
- Sub-managers are generally limited to under $2 billion of firm-wide assets under management at time of initial funding."

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16 Press release: http://qemp.ca/news-about-the-quebec-emerging-managers-program/

17 https://www.cppinvestments.com/about-us

18 https://www.bloomberg.com/news/articles/2018-03-05/canada-pension-backs-fledgling-hedge-funds-as-titans-disappoint?sref=rC6PDrIm

19 https://www.bloomberg.com/news/articles/2018-03-05/canada-pension-backs-fledgling-hedge-funds-as-titans-disappoint?sref=rC6PDrIm

20 All quotes in this section from https://comptroller.nyc.gov/services/financial-matters/pension/initiatives/emerging-manager-program/

Additional requirements cited (dependent on strategy) include:

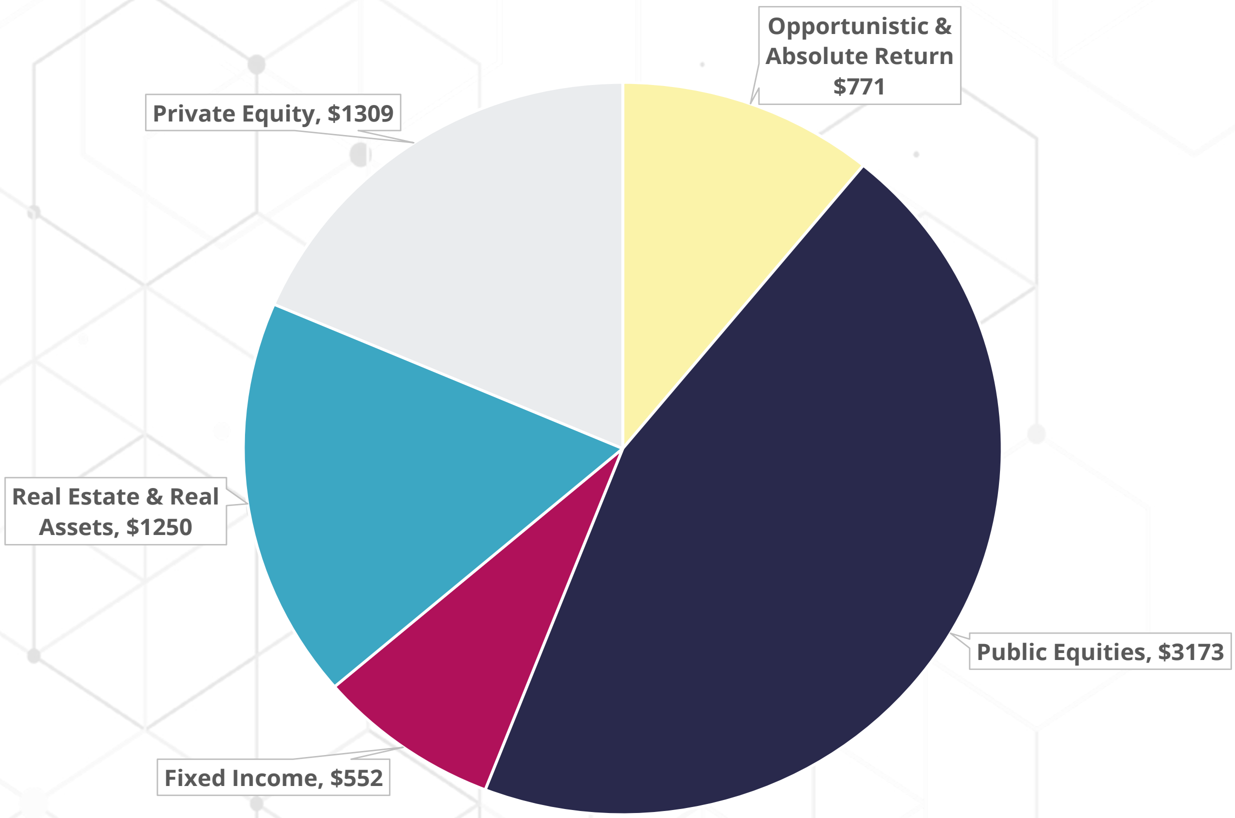
- "Institutional quality operations with established front/back office, systems and risk management including reputable administrators, auditors and an independent third-party pricing source where appropriate.
- Broad institutional capital base with significant General Partner investment.
- Have a broad institutional investor base."

It is worth noting that requirements like this may even exceed what Canadian emerging managers are able to meet from a minimum AUM and institutional investor base perspective.

iv. The New York State Comptroller – New York State Common Retirement Fund,[21] New York, USA

"The Emerging Manager Program offers opportunities to newer, smaller and diverse investment management firms to help grow the State's Common Retirement Fund. The Emerging Manager Program of the New York State Common Retirement Fund (the Fund) invests with emerging managers directly, or with the assistance of managers of managers or program partners, in separately managed accounts or commingled funds. Program partners assist in the timely deployment of capital, perform due diligence and recommend managers to participate in the program. Each year, the Fund also seeks to graduate emerging managers to be mature direct investments by the Fund. More than 20 emerging managers have graduated from the Emerging Manager Program. As at March 2019, $7B had been committed to the Emerging Manager program," across a variety of strategies and asset classes, as noted below.

"The Fund is committed to opening doors that were sometimes shut in the past to minority- and women-owned businesses. Promoting the participation of these firms brings in new ideas, perspectives and personnel, helping the Fund continue to earn strong returns."



21 All quotes in this section from https://www.osc.state.ny.us/pension/emerging/index.htm

The program has also identified “attributes of successful newly formed and emerging firms,” in addition to specific life cycle considerations gleaned from the same survey:

Attributes of successul newly-formed and emerging firms

High Importance	Medium Importance
• Years of team experience in managing the strategy • Years of prior institutional work experience (competitor training) • Years of leadership team has been working together • Private business, owner-managed	• Size of AUM strategy or fund • Well-considered strategic growth plan • Years managing institutional capital

Source: 2018 NYSCRF Survey conducted by Bard Consulting

Life cycle considerations within a portfolio approach, the Fund and program partners seek to diversify exposure by stage of emerging manager life cycle. Informed by the 2018 survey, the Fund considers the following guidelines when evaluating business life cycle stages.

Stage	Traditional Attributes for the Stage
Seed & Early Firm tipically has managed money for institutional investors less than five years	• Access to sufficient capital to procure appropriate infrastructure; • Growing base of investors; • Access to sufficient capital for investment team build-out and co-investment in the strategy that is meaningful for alignment; and • Sufficient full-time staff with tenured industry experience
Mid & Late	• Well capitalized firm that shows positive operating cash flows; • Key internal infrastructure in place, with redundancies in mission-critical investing and operating processes; • Reasonable growth assets under management (AUM) in last three years; • Increased breadth of ownership and reduced key person risk; • Increased diversification of investors by type of investor; and • Established appropriate environmental, social and governance (ESG) policies and procedures

Source: https://www.osc.state.ny.us/common-retirement-fund/emerging-manager/emerging-manager-definition-and-life-cycle

v. Employees Retirement System of Texas,[22] Texas, USA

"In selecting managers, advisors, consultants, and other financial service providers, the Board shall make a good faith effort to evaluate qualified emerging firms as candidates to award contracts to or acquire services from when acquiring private financial services as set forth in Texas Government Code § 815.301 (g), (h), and (i). An emerging fund manager is defined as a private professional investment manager with assets under management of not more than $2 billion.

ERS has established an emerging manager program to find smaller managers that can benefit the Trust by enhancing risk-adjusted returns, net of fees. Staff have determined that, over the long term, inclusion of emerging managers as part of external investment management should enhance and diversify the Trust's 10 expected investment returns, serving to complement the Trust's internal investment management. ERS emerging manager program is integrated within each asset class.

ERS' philosophy is that broadening the investment opportunity set of external managers to include smaller, newer, and diverse managers is expected to have many benefits for the Trust. Benefits cited include:

- Smaller managers have proven in research to deliver competitive risk-adjusted investment returns.
- Employee-owned firms tend to have a stronger alignment of interest with investors.
- Entrepreneurial managers can provide ERS with unique investment strategies and diversity of thought.
- This program can provide the Trust with long-term access to the next generation of talent."

In 2018, ERS expanded this program with a partnership with PAAMCO Launchpad to "a meaningful opportunity to hedge fund managers that have the foundation to grow into successful and profitable businesses."[23]

vi. EFSI Private Credit Programme[24]

"Diversified debt funds are an alternative source of flexible, tailor-made debt financing for businesses, including SMEs, in Europe. This market emerged in response to the retrenchment of banks and other traditional lenders after the financial crisis.

Today it provides SMEs with a broader choice of financing options, as well as offering investors an asset class that links institutional savings with real economic growth. The programme is a continuation, and expansion, of the EIF's existing support of diversified debt funds.

So far, the EIF has committed around EUR 550m to 12 diversified debt funds, expected to mobilise over EUR 5bn debt financing for the benefit of approximately 1800 SMEs and small mid-caps.

22 https://ers.texas.gov/Doing-Business-with-ERS/PDFs/ERS-Investment-Policy.pdf

23 https://www.prnewswire.com/news-releases/paamco-introduces-innovative-seeding-platform---paamco-launchpad---with-inaugural-partner-employees-retirement-system-of-texas-300671842.html

24 https://www.eif.org/what_we_do/guarantees/efsi-pcp/index.htm

The goal of the EFSI Private Credit Programme is to:

- Channel private institutional investment into diversified debt funds
- Increase the volume and diversity of alternative debt financing available to European SMEs and small mid-caps
- Support market-based, tailor-made funding solutions
- Contribute to the development of a Capital Markets Union by supporting pan-European investment activity

The EIF makes an equity investment in eligible diversified debt funds selected after a detailed due diligence and negotiation process. In some circumstances, the EIF may also provide bilateral, unfunded credit protection to investors, further encouraging support to this nascent asset class.

The EIF aims to select diversified debt funds (financial intermediaries) managed by both established and new private fund managers. Eligible diversified debt funds shall apply a portfolio approach, investing in a relatively high number of predominantly senior financing facilities to be extended to SMEs and small mid-caps in the EU."

vii. IMQubator, the Netherlands (former)

"Capitalised in January 2009 with €250m from the Netherlands' APG Asset Management following the recommendation of a working group from the Holland Financial Centre, IMQubator intermediates the allocation of seeding and operational capital from third-party institutional investors to early-stage boutiques."[25] Financial backing is given emerging alternative asset managers "on the condition that they operate from the Netherlands."[26]

viii. Massachusetts Pension Reserves Investment Management Board (MassPrim)

"For this mandate, MassPRIM defines emerging hedge fund managers as those managing less than $500 million. Employing a sophisticated and efficient process, Innocap and NewAlpha Asset Management assessed over 250 managers from around the globe and filtered a few select candidates that were discussed in-depth with MassPRIM. To date, MassPRIM has allocated funds to 5 managers and is set to launch more in 2020, reflecting its rigorous selection criteria."[27]

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25 https://www.ipe.com/boutique-asset-managers-imqubator-giving-talent-a-push/44611.article

26 https://www.ipe.com/apg-makes-first-imqubator-investment/31871.article

27 https://www.innocap.com/en/innocap-and-newalpha-1st-anniversary-massprim/

About Alternative Investment Management Association (AIMA)

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment funds, futures funds and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises approximately 2000 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2 trillion in assets under management. AIMA Canada, established in 2003, now has more than 130 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount investment exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Advisers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes large bank-owned securities firms and top accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our websites at canada.aima.org and www.aima.org.

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