AIMA

AIMA Canada Handbook 2024:

Canadian Alternative Investment Landscape

Over 40 events annually in Canada, including the AIMA Global Investor Forum (AGIF)

Educational resources include:

Canada Handbook 2024

Launching Alternative Mutual Funds Handbook

AIMA/CAIA Risk Rating Guidelines

Advisor DDQ one-pager

CE Credit Presentations

Advisor Guide to Alts in Canada

AIMA Canada was established in 2003 to align and contribute to global sound practices

Canadian peer groups and committees available for regulatory, compliance, legal and investor insights

AIMA meets regularly with CSA, CIRO, Depoartment of Finance and other regulatory/political stakeholders

Investor focus includes institutional, family offices and retail investors

Over 165 corporate members in Canada, including institutional and retail investors

For more information about AIMA Canada:

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AIMA was originally founded in 1990

AIMA's quarterly Journal shares thought leadership published by members

Globally, AIMA has offices in New York, Washington DC, London, Brussels, Singapore, Hong Kong, Shanghai, Sydney and Tokyo

Access to over 40 industry guides, modular DDQ for investment managers and 20 other DDQs

AIMA has over 300 meetings per year on average with policy makers globally, submitting 100 written submissions annually on average

150+ Member Peer Groups globally include:

Investor Steering Committee

Investor Relations & Business Development

Sounds Practices

Next Generation Manager

Digital Assets & Blockchain

Operational Due Diligence

AIMA holds over 200+ events globally, including over 10 flagship events

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Vision 2027: Canadian Alternative Roadmap

By: Claire Van Wyk-Allan, CAIA

Managing Director, Head of Canada and Investor Engagement, Americas, AIMA

The vibrancy of the Canadian alternatives market has never been brighter.

Interest and investment in alternative strategies continues to grow across institutional, family office and wealth channels. Canada is proud to boast a consistently growing hedge fund market, now nearly US$138B according to Preqin. Liquid alts, now over CAD $30B in AUM in 5 years, have propelled access for alternatives in wealth channel in a structure that continues to evolve through various exemptive reliefs to best align structures for the strategies.

Global managers are increasingly distributing products not only to institutions, but also now to wealth channels, benefiting investors with additional choice and access to alternatives. The current OSC Long-Term Assets proposal is bound to bring further flexible structures for alternative investments in the future.

All around the globe though, competition for capital, operational costs and regulatory burden are rising for alternative managers. Consolidation too is high, with PwC estimating that half of assets under management will be controlled by 10 firms by 2027.

Quebec proudly features a strong emerging manager program supporting new and small managers in the province. As Canada faces an entrepreneurship gap generally, with less than half as many people launching new businesses as they did 20 years ago according to BDC, further programs across the country might help fuel more locally-managed investment funds and position Canadian talent to continue to lead asset management globally for the years to come.

AIMA Canada is committed to ensuring a level-playing field where local regulation is consistent globally and Canadian manager access to capital is fair and strong. In our AIMA Canada Vision 2027 for alternatives in Canada, these themes stand out to grow our alternatives market with vibrancy in the short-term future and years to come:

1. **Increased emerging asset manager entrepreneur support**

   This might include further provincial, national and/or independently-run programs or shared services to minimize operational costs of excellence to increase capital allocated to more managers and more funds at home.

2. **Improved regulatory alignment with other prominent jurisdictions and structures**

   This might include improved registration timelines, less prohibitive proficiency requirements, confidential pre-registration, harmonized provincial system, ability to adopt pass-through expenses, codified exemptive relief for NI 81-102 alternative funds.

3. **Minimized barriers to wealth channel adoption**

   This might include improved shelf access for third-party managers and funds of all sizes and track records, risk ratings that align with historical risk-adjusted performance of the fund or strategy, expanded CIFSC alternative fund categories, Client Focused Reforms' KYP processes that compare long-only and alternative funds, automated solutions that improve workflow efficiency while minimizing paperwork, minimized proficiency requirements.

4. **Next generation talent engagement heightened**

   This might include more next gen talent participating in industry initiatives, improved DE&I practices across firms, high school and university education inclusion to ensure a strong talent pipeline of successors.

5. **Alternatives in mainstream media**

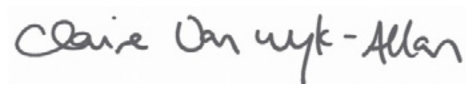
   This might include more features on alternative assets, strategies and managers and more press mentions of AIMA research or thought leaders.

In this AIMA Canada Handbook 2024 edition, we're thrilled to present an overview of the alternative investment landscape in Canada. From investors – institutional, family office and wealth – to alternative asset classes – hedge funds, private credit, digital assets, real estate – and to regulatory highlights, there is a wealth of context shared which will help readers better understand and navigate the local market.

The people and community they form here together are the magic behind our alternative investment market in Canada. AIMA Canada is a proud collective of collaborators, who lead together with a unified voice to elevate our industry locally and globally with education, regulatory advocacy and operational sound practice while improving stakeholder investment outcomes.

Wherever you are reading this in the world, we hope Canada is a leading destination of choice for you for alternative investments. We look forward to welcoming you here!

Warmly,



Claire Van Wyk-Allan, CAIA

Managing Director, Head of Canada & Investor Engagement, Americas, AIMA

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Institutional Investors - Canada's Maple Eight

By: Scott McEvoy
Partner, BLG

Borden Ladner Gervais

An important segment of Canada's institutional investor landscape, are the so-called "maple revolutionaries"[1] (referred to herein as the Maple Eight). Eight public pension funds in Canada account for approximately $2.0 trillion of public pension money for the benefit of millions of Canadians. In Chapter 3 we provide brief summaries of each of these eight plans including asset mix and geographical distribution of their investments.

Pension funds have been described as the only global investor class which has a fiduciary duty to invest across generations[2]. The emphasis on intergenerational equity and balancing long-term performance of investments against present and medium term beneficiaries is set against the pension plan's primary risk of not being able to pay pensions and fulfil the plan's promise to members, former members, and other persons entitled to benefits under the plan. This principle underlies and informs the need for pension plans to have strong governance structures and effective frameworks for managing risk.

Characteristics of the Canadian Model of Public Pension Investment

The Maple Eight stand apart from most other Canadian and many foreign pension funds due to their size, operations and investing strategies. Their common characteristics include:

- use of internal management made possible by their economies of scale;
- reliance on investment strategies designed to capture the liquidity premiums offered by less-liquid alternative assets;
- diversification across a broader set of asset classes, investment styles and geography;
- use of leverage and derivatives designed to improve returns and mitigate risks;
- reliance on in-house risk-management functions; and
- competitive compensation with the private sector to attract and retain talent.[3]

The Maple Eight are of interest for many reasons including their interconnectedness with other financial institutions in Canada. For example, much work has been published examining common exposures in asset holdings among financial institutions including pension plans. This work has included analysis of common exposures using climate-related public assets (equity and debt) held by financial institutions. The greater the overlapping exposures to a given set of assets, the more vulnerable an entity may be to a given shock affecting those assets. [4] The annual reports of the Maple Eight contain references and discussions of the sophisticated climate change scenario analysis and testing used to assess potential future impacts of climate risk-related stress events. Such impacts are monitored and factored into the range of climate- related risks [and opportunities] as a part of a plan's investment strategy and portfolio design.

In Canada, when administering and investing pension fund assets, a plan administrator is subject to standards of prudence, care, diligence and skill. The prudent person rule is a substantive rule of law that is intended to lead to balanced decision making, rather than dictate particular outcomes[5]. It is the administrator's responsibility as a fiduciary to act prudently to identify risks and opportunities that may impact the plan. Recent guidance by the Canadian Association of Pension Supervisory Authorities sets out that using environmental, social, and governance (ESG) information to provide financial insight is consistent with an administrator's fiduciary duty. Conversely, ignoring or failing to consider ESG information that might materially affect the pension fund's financial risk-return profile could be a breach of fiduciary duty[6].

The Maple Eight have become leaders in encouraging companies and investors to provide consistent and complete ESG information to strengthen investment decision-making and better assess and manage their collective ESG risk exposures. Since the last version of this AIMA Handbook, the CEOs of the Maple Eight investment managers joined together to issue a request that Canadian corporations measure and disclose their performance on material, industry-relevant ESG factors by leveraging the Sustainability Accounting Standards Board (SASB) standards and the Task Force on Climate-Related Financial Disclosure (TCFD) framework to further standardize ESG-related reporting.[7] CPP Investments was a founding member of TCFD and achieved full adoption of its recommendations in fiscal 2021[8].

Canadian Taxonomy

The very recent announcement by the Government of Canada of a classification system to define what qualifies as "green" and "transition" economic activities (Canadian Taxonomy)[9] illustrates the important work of the Maple Eight in the development of sustainable investment guidelines in Canada.

In May 2021, the Government of Canada launched the Sustainable Finance Action Council (SFAC) to help lead the Canadian financial sector towards integrating sustainable finance into standard industry practice. SFAC is composed of the twenty-five largest financial institutions and pension funds (including the Maple Eight) in Canada. A working group was established and report prepared providing recommendations on how to mobilize private capital to support decarbonization and climate-related resilience in the Canadian economy.

One recommendation and outcome of SFAC's work was its Taxonomy Roadmap Report[10]. The Government of Canada's commitment announced on October 9, 2024 is to a Canadian Taxonomy that would define which economic activities are green (low or zero-emitting activities, such as green hydrogen, solar and wind generation, or those that enable them, such as electricity transmission lines and hydrogen pipelines); and transition (decarbonizing emission-intensive activities that are critical for sectoral transformation and consistent with a net-zero, 1.5 °C transition pathway, such as installing lower-emitting (electric) furnaces to produce steel). The commitment is for Phase 1 of the Canadian Taxonomy with eligibility criteria for two to three priority sectors to be released within 12 months of an arms-length third party organization beginning its work[11].

Canada will now become one of the jurisdictions worldwide that are developing or have implemented taxonomies. By the Government of Canada's own estimates achieving net-zero emissions by 2050 will require between $125 billion and $140 billion in investment into Canada every year.

SFAC's work of ensuring better access to climate data and analytics as well as common standards for sustainable and low-carbon investments, supported by the scale, talent and efforts of the Maple Eight, along with other financial institutions and advisory bodies, will assist Canada in its transition to a net-zero emissions economy by 2050.

1 "Maple revolutionaries: Canada's Public Pension Funds Are Changing the Deal-Making Landscape," The Economist, March 3, 2012 (www.economist.com/finance-and-economics/2012/03/03/maple-revolutionaries).
2 Keith P. Ambachtsheer, The Future of Pension Management (Hoboken, New Jersey, 2016)
3 Large Canadian Public Pension Funds: A Financial System Perspective. Bank of Canada. Financial System Review 2016.
4 Understanding the Systemic Implications of Climate Transition Risk: Applying a Framework Using Canadian Financial System Data. Bank of Canada. Staff Discussion Paper. December 20, 2023.
5 Canadian Association of Pension Supervisory Authorities, Guideline No. 6 (November 15, 2011).
6 Canadian Association of Pension Supervisory Authorities, Guideline No. 10 (September 9, 2024).
7 CEOs of eight leading Canadian Pension plan investment managers call on companies and investors to help drive sustainable and inclusive investment growth, November 25, 2020.
8 2023 Report on Sustainable Investing. CPP Investments.
9 Department of Finance Canada News Release October 9, 2024
10 Taxonomy Roadmap Report: Mobilizing Finance for Sustainable Growth by defining Green and Transition Investment, Sustainable Finance Action Council (September 2022)
11 Department of Finance. Government advances Made-in-Canada sustainable investment guidelines to accelerate progress to net-zero emissions by 2050. Backgrounder October 9, 2024.

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Canadian Institutional Investor Profiles

By: Scott McEvoy
Partner, BLG

By: Mishail Khan
Articling Student, BLG

Borden Ladner Gervais

With special thanks to CIBC Capital Markets who first produced this section in 2019

CPP Investment Board (CPPIB)

The CPP Investment Board was established by an Act of Parliament in December 1997. CPPIB is accountable to Parliament and to the federal and provincial Finance ministers who serve as the CPP stewards. However, CPPIB is governed and managed independently from the CPP itself, and operates at arm's length from governments.

CPPIB invests globally across a wide range of asset classes through both passive and active investing. CPPIB adopts a truly global perspective as they invest across a wide range of asset classes.

CPPIB oversees and invest a contributory, earnings-related social insurance program on behalf of employees in all provinces and territories except Quebec.

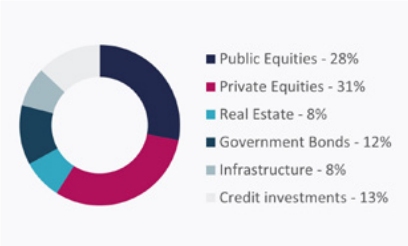
Key Data

Total AUM	CAD $632 bn
Total Investments	CAD $806 bn
F24 Rate of Return	**8.0 %**
10 Year Rate of Return	9.2%
International Offices	- Hong Kong - London - San Francisco - Sydney - New York - Mumbai - Sao Paulo

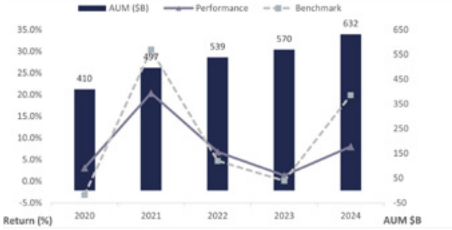
Asset Mix

By Asset Class

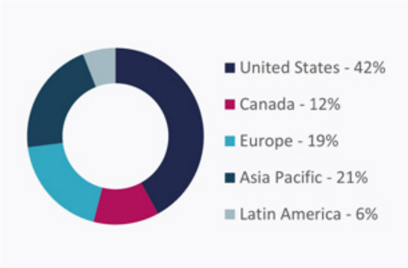
As at March 31, 2024



AUM Historical Performance



By Geography



Public Sector Pension Investment Board (PSP)

The PSP Investment Board was established by an Act of Parliament in September 1999. The responsible Minister is the President of the Treasury Board. However, the board is managed by a board of ten directors, including the chairperson, appointed by the Governor in Council. PSP is operating at arm's length from governments.

PSP manages a diversified global portfolio composed of investments in public financial markets, private equity, real estate, infrastructure, natural resources and private debt.

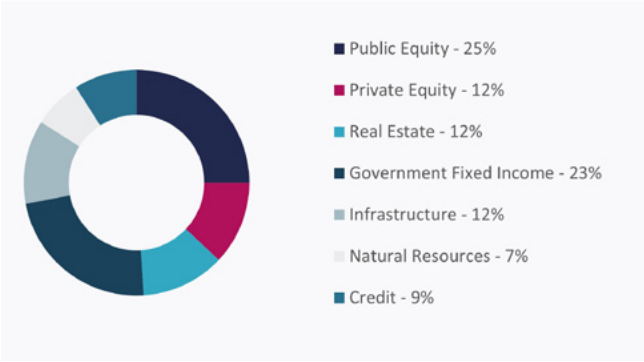
PSP invests funds for the pension plans of the Public Service, Canadian Armed Forces, the Royal Canadian Mounted Police and the Reserve Force.

Key Data

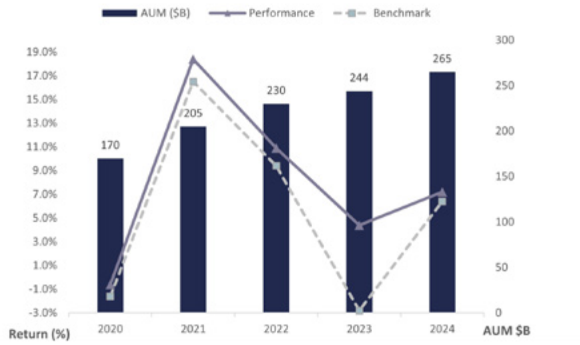
Total AUM	CAD $265 bn
Total Investments	CAD $265 bn
F24 Rate of Return	**7.20%**
10 Year Rate of Return	8.30%
International Offices	- New York - London - Hong Kong

Asset Mix

By Asset Class



AUM Historical Performance



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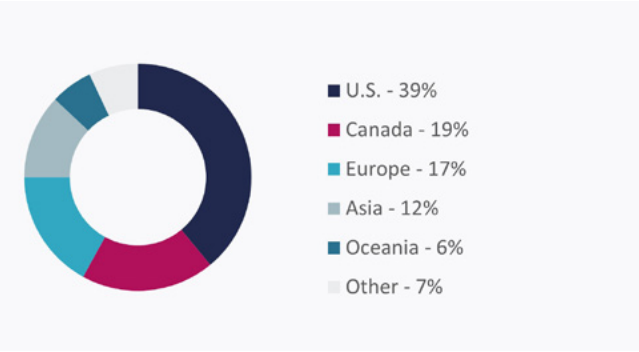


Ontario Municipal Employers Retirement System (OMERS)

The Ontario Municipal Employees Retirement System (OMERS) was created by statue in 1962. OMERS is governed by the Ontario Municipal Employees Retirement System Act, 2006, an Ontario law which superseded the older Ontario Municipal Employees Retirement System Act. OMERS is composed of the Administration Corporation which provides strategic, risk and operational management and the Sponsors Corporation which provides oversight and decision-making.

OMERS investment strategies cover a diverse range of assets in public and private markets.

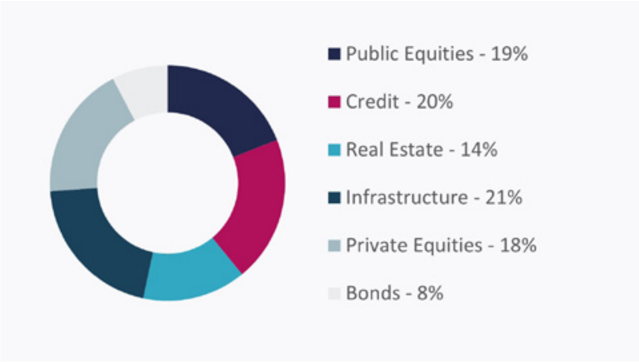
OMERS is a jointly sponsored defined benefit pension plan with over 1,000 participating employers ranging from large cities to local agencies. OMERS manages the retirement benefits of union and non-union members employed by municipalities, school boards, local boards, transit systems, electrical utilities, emergency services and children's aid societies across Ontario.

Key Data

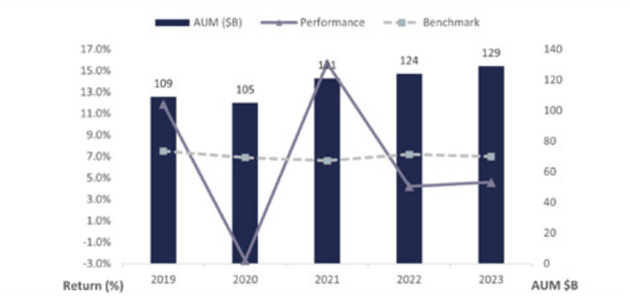
Total AUM	CAD $129 bn
Total Investments	CAD $131 bn
F23 Rate of Return	**4.60%**
10 Year Rate of Return	7.30%
International Offices	- New York - London - Sydney - Amsterdam - Luxembourg - Singapore

Asset Mix

By Asset Class



AUM Historical Performance



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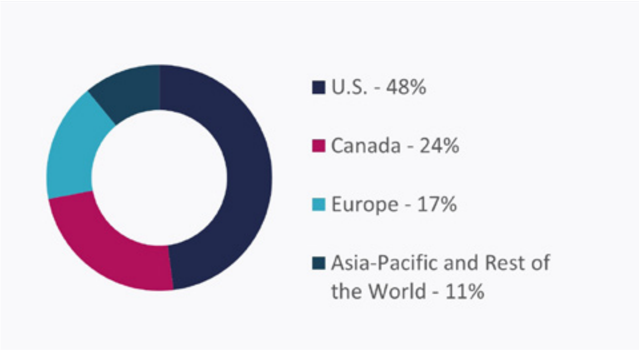


British Columbia Investment Management Corp (BCI)

British Columbia Investment Management Corporation (BCI) began operations under the Public Sector Pension Plans Act in 1999 to provide investment services to British Columbia's public sector. BCIMC has a seven-member Board of Directors, structured in accordance with the Public Sector Pension Plans Act. The four statutory pension plans (College Pension Plan, Public Service Pension Plan, Municipal Pension Plan and the Teachers Pension Plan) each appoint one director. The Minister of Finance appoints three directors, two of whom are representatives of BCI's other clients. The third appointee by the Minister is designated as the chair of the Board.

BCI is an active, in-house asset manager investing globally across a range of asset classes.

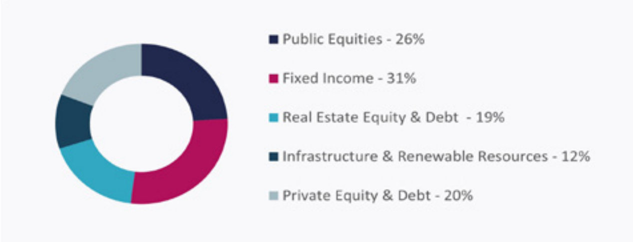
BCI invests globally on behalf of public sector clients, which includes 10 public sector pension funds, three insurance funds, and 16 special purpose funds comprised of public trusts, endowments, and government bodies, for 740,000 pension plan beneficiaries, 2.7M British Columbia workers and 4M Autoplan holders.

Key Data

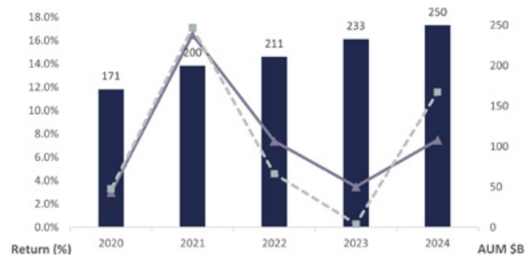
Total AUM	CAD $250 bn
Total Investments	CAD $250 bn
F24 Rate of Return	**7.50%**
10 Year Rate of Return	7.80%
International Offices	- New York - London

Asset Mix

By Asset Class



AUM Historical Performance



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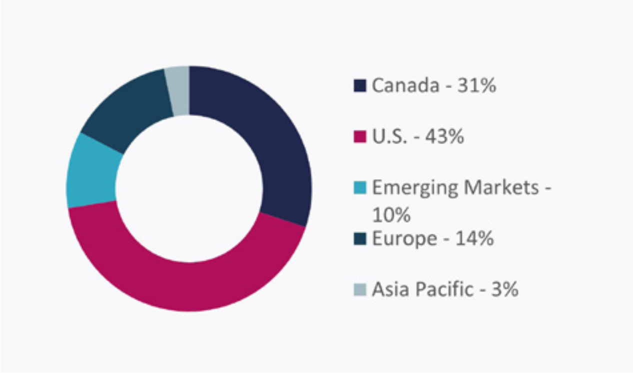


Healthcare of Ontario Pension Plan (HOOPP)

The Healthcare of Ontario Pension Plan was established January 1, 1960 under the Pension Benefits Act. The Board of Trustees govern all aspect of the HOOPP Plan and the HOOPP Fund. The Board is made up of 16 voting members – eight trustees are appointed by the Ontario Hospital Association and four unions each appoint two trustees.

HOOPP's liability driven investing approach considers the plan's assets in relation to how much the plan owes in pensions. This approach helps determine appropriate investments and reduces funding risk.

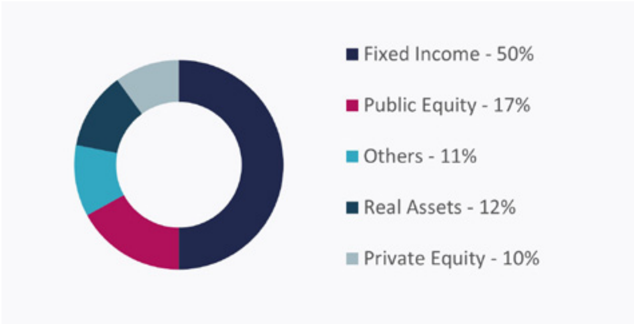
HOOPP is a contributory defined benefit multi-employer pension plan for Ontario's hospital and community-based healthcare sector with more than 670 participating employers.

Key Data

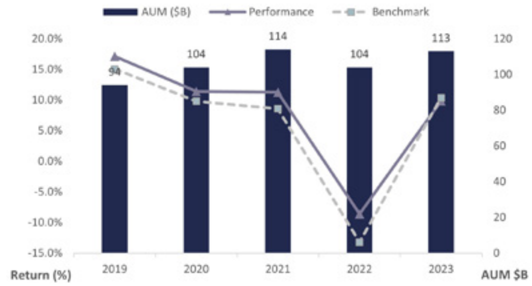
Total AUM	CAD $113 bn
Total Investments	CAD $112 bn
F23 Rate of Return	**9.38%**
10 Year Rate of Return	8.43%
International Offices	- London

Asset Mix

By Asset Class



AUM Historical Performance



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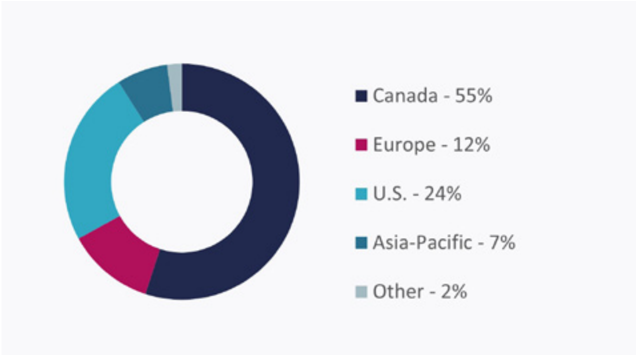


Ontario Teachers' Pension Plan (OTPP)

The Ontario Teachers' was established on January 1, 1990 as a multi-employer pension plan jointly sponsored by the Government of Ontario and the Ontario Teachers' Federation (OTF). As joint sponsors, the OTF and the Ontario government set benefit levels, establish contribution rates and manage funding. OTPP is run by an independent Board of eleven members, appointed by the OTF and the Ontario government.

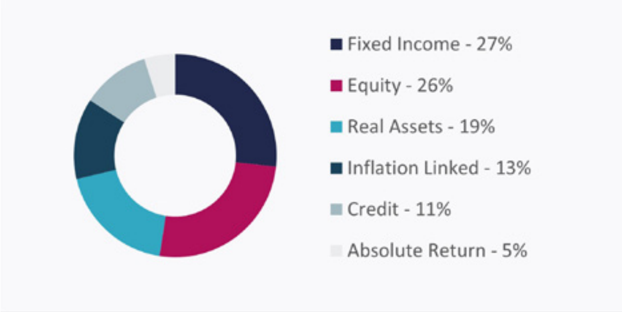
OTPP owns and manages a diversified portfolio of Canadian and international assets. It also owns a real estate subsidiary - Cadillac Fairview.

Key Data

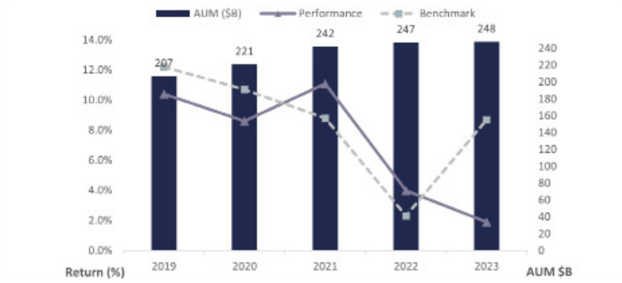
Total AUM	CAD $248 bn
Total Investments	CAD $244 bn
F23 Rate of Return	**1.90%**
10 Year Rate of Return	7.6%
International Offices	- London - Hong Kong - Singapore - Mumbai - San Francisco - New York

Asset Mix

By Asset Class



AUM Historical Performance



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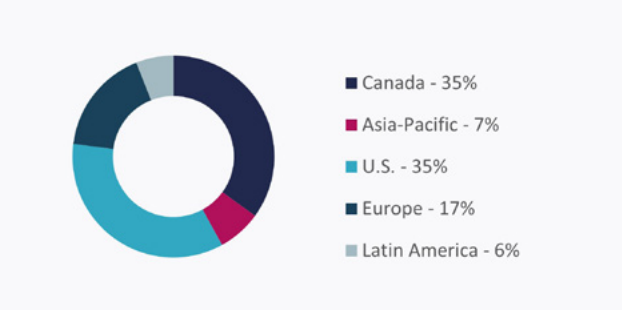


Caisse de dépôt et placement du Québec (CDPQ)

Caisse de dépôt et placement du Québec (CDPQ) was founded in 1965 and is headquartered in Quebec City, Quebec. CDPQ is Canada's lead private equity investor, one of the largest institutional fund managers in North America, and one of the 10 largest real estate asset managers in the world. CDPQ has three subsidiaries: Ivanhoé Cambridge, Otéra Capital and CDPQ Infra.

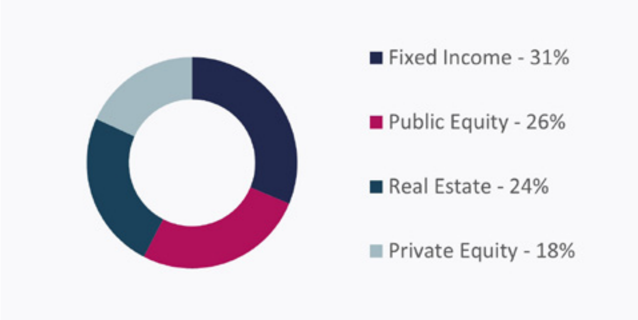
CDPQ manages several public and parapublic pension plans and insurance programs in Quebec. CDPQ invests its depositors' funds for the benefit of 6 million Quebecers that covers more than 45 retirement and insurance plans funds. CDPQ invests the funds in both Quebec's economy and in close to 70 countries.

Key Data

Total AUM	CAD $434 bn
Total Investments	CAD $505 bn
F23 Rate of Return	**7.20%**
10 Year Rate of Return	7.40%
International Offices	- London - Mexico City - Delhi - Sao Paulo - New York - Paris - Sydney - Singapore

Asset Mix

By Asset Class



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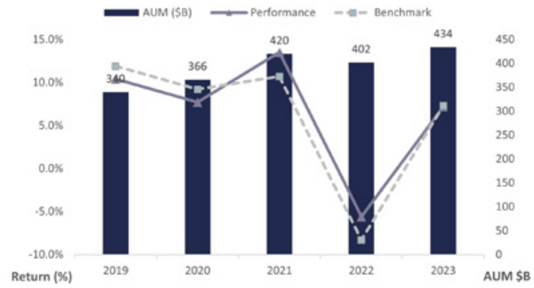

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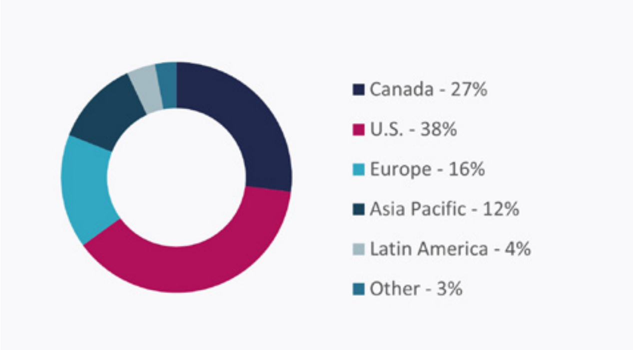


Alberta Investment Management Corporation (AIMCo)

AIMCo was established as a Crown corporation on January 1, 2008 after passing legislation creating AIMCo in 2007. AIMCo is responsible for the investments of 26 pension, endowment, government, specialty and other balanced fund clients in Alberta, helping to ensure prosperity for several hundred thousands public sector employees, and all Albertans benefitting from the Alberta Heritage Savings Trust Fund. AIMCo places investments across all asset classes and markets to maximize return on risk.

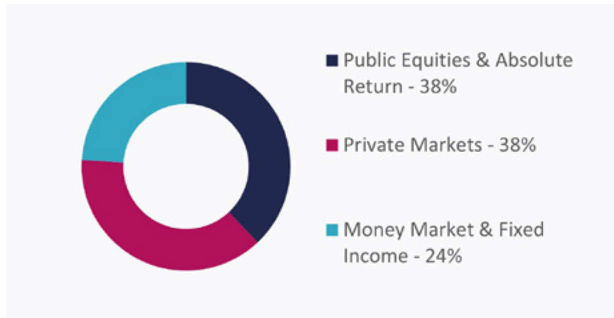
AIMCo's assets are invested in segregated investments owned by clients or aggregated in one or more pooled investment portfolios managed by AIMCo. Some of these assets are managed by third-party investment managers selected and monitored by the AIMCo in order to achieve greater diversification, as well as to access external expertise and specialized knowledge.

Key Data

Total AUM	CAD $161 bn
Total Investments	CAD $161 bn
F23 Rate of Return	**8.00%**
4 Year Rate of Return	5.30%
International Offices	- London - Luxembourg - New York - Singapore

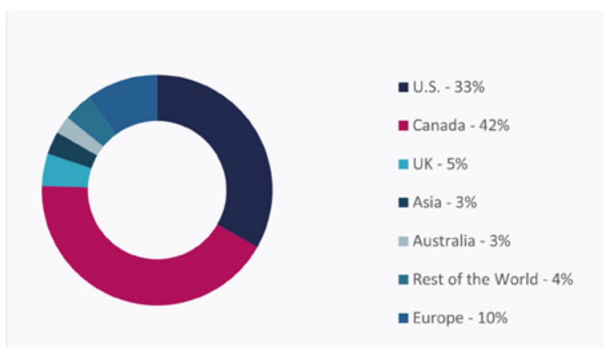
Asset Mix

By Asset Class



AUM Historical Performance

By Geography



4

A Canadian Pension Plan's Approach to its Total Investment Portfolio

By: David Ross

Senior Managing Director, Total Portfolio Management , OPTrust

Few Canadians are likely to consider giving thanks to Augustus Caesar, the first Roman Emperor, but he is nonetheless credited with inventing the world's first pension plan (thanks Augustus). In a world of increasing retirement anxiety, many Canadians can look forward to their pension income in retirement with a relatively high degree of certainty. This includes the close to 22 million Canadians who are active participants in the Canada Pension Plan, as well as the millions of others who are members of public sector, defined benefit plans such as OPTrust.

Augustus instituted the Aerarium Militare, a permanent revenue source for veterans of his Imperial Roman army. This plan awarded an arguably generous discharge benefit equivalent to twelve years of pay to a soldier who completed twenty years of service as a legionary, or sixteen years in the Praetorian Guard. While Augustus Caesar's contributions get ignored, many Canadians can be thankful for the Maple Model. This term refers to the investment and governance approach that has been adopted in varying degrees over the last three decades by most of Canada's large defined benefit, public sector pension plans.

The success the Maple Model has achieved in delivering retirement security to its members can be attributed to several key features. These include a direct approach to the internal management of investments, the pursuit of diversification across a wide range of asset classes and geographies, a willingness to partner with like-minded investors, a focus on developing and supporting cost-effective, in-house expertise and last, but most importantly, a commitment to a strong governance model that includes both transparency and accountability in the service of plan members.

While all share these general features, each Plan tailors its investment approach to the mandate it has been granted by its sponsors as well as its specific needs and objectives. These needs and objectives vary based on a number of factors, including the size and maturity of a Plan and also its tolerance for risk.

OPTrust, with net assets of $25 billion, invests, manages and administers the OPSEU Pension Plan (including OPTrust Select), a defined benefit plan with over 111,000 members. Based on asset size, OPTrust is Canada's tenth largest pension plan. OPTrust's application of the Maple Model, an approach we call Member Driven Investing, ensures that our investment strategy is fully aligned with our membership's pension security. Our investment objective is to increase the likelihood of the Plan remaining fully funded over the long term by maximizing returns at an acceptable level of risk. Our tolerance for risk is guided by the maturity of our plan. With payments to retired members exceeding contributions, we have a higher maturity and a lower risk tolerance than some of our Canadian peers.

We believe the success of our Member Driven Investing strategy in large part lies with the holistic approach we take to the Investment Portfolio. This Total Portfolio Approach recognizes that it is the long-term return on the entire portfolio, not its constituent parts, that pays pensions.

OPTrust's approach to constructing our total portfolio begins with the illiquid investments at its core. These are private markets investments, primarily in private equity, infrastructure and real estate, managed by our internal team. Recognizing the value creation and stability of returns available in these illiquid investments, the remainder of our portfolio is built around them - allocating to the liquid public markets strategies that allow us to "complete" the Total Portfolio with the characteristics and risk factor exposures that we desire. These liquid strategies provide diversification, returns and risk mitigation for the Plan.

Focusing squarely on our Total Portfolio objectives, our time-varying allocations to these liquid strategies enable us to manage the Plan's risk profile as market conditions change, and our long-term risks and opportunity set evolve. By avoiding silos within the investment team, we ensure that our capital, talent and available risk budget is always being deployed where it can best serve the needs of our members.

As a $25 billion plan, we are well attuned to the economies of scale that are and are not available to us within our investment platform. While we have developed a cost-effective and highly skilled internal investment team, we also highly value our external partner relationships for the expertise and value they bring to our investment portfolio. With roughly one quarter of our assets managed externally and three quarters managed internally, we believe we have struck the right balance for a pension plan our size.

We bring a similarly tailored approach to geographic diversification within our portfolio. Within our illiquid allocations, deal sourcing in developed markets is supported by our two international offices in London and Sydney. These outposts ensure strong local relationships and oversight. Our approach to emerging markets has been to focus on public markets exposure, with a liquidity profile that is appropriate for our size, scale and tolerance for risk.

The Maple Model continues to evolve, and many of our Canadian pension peers are also adopting a total portfolio-based approach. Like many of our peers, we have adopted a climate strategy that addresses the risks and opportunities presented by the transition to a net-zero economy, while maintaining our pension promise to our members. In the past 18 months, we and many of our peers, have begun a proactive approach to managing the rapid changes occurring in Artificial Intelligence technology. We want to ensure we are well positioned; with the knowledge and the tools we need to manage the risks and seize the opportunities that technological change is creating. Again, our approach here has been holistic, incubating small investments in this area while taking a top-down approach to information sharing and the adoption of new technologies by teams across the Plan.

As Augustus Caesar and his Roman successors learned, both the funding and management of a pension plan are critical to its success. Augustus initially capitalized his plan with his own money, but over time this proved insufficient and unpopular taxes were required as a source of funding. Today, most Maple Model adherents enjoy an enviable funded status. Maintaining the key features of this model, in particular its strong governance framework, while focusing on the needs and objectives of the total investment portfolio, should allow us and our peer plans to maintain a long-term focus and successfully navigate the challenges that lie ahead.

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On the Sustainability of the Canadian Model

By: Eduard van Gelderen

Head of Research, FCLTGlobal

FCLTGLOBAL

The Canadian model is generally regarded is one of the most successful investment models. Historical performance shows good risk adjusted returns, outperforming passive investment strategies and other investment models.

This performance is attributed to four specific characteristics: its governance, large allocation to private markets, internal management and the focus on long-term value creation.

The central question in this study is to what extent the Canadian model can be as successful in the future as it has been since the launch of the model over twenty years ago.

The first part of the paper studies the specific characteristics to determine whether the group of institutions pursuing the Canadian model, the so-called Maple-8, are a homogenous group or a merely a diverse group using similar principles.

The second part of the paper discusses the current state of the model based on interviews with the Maple-8's c-suite and subject matter experts.

The overarching message is that the Canadian model should first and foremost remain focused on value creation and must seek the reassertion of its license to operate. Improvements of the model can be found in risk management and the use of technology.

The model provides a good opportunity to further strengthen Canada's pension system.

Read the full paper here

6

Economic and Social Vitality: The Evolution of Canada's Family Offices

By: Yannick Archambault

Partner, National Leader – Family Office, KPMG in Canada

KPMG | FAMILY OFFICE

Family offices are private wealth management firms designed to serve ultra-high-net-worth (UHNW) individuals and families. In Canada, family offices are usually categorized by asset size, complexity, depth and breadth of services. Multi-family offices (MFOs) typically support families with assets between $30 and $500 million, managing the needs of multiple families and providing turnkey solutions. Single family offices (SFOs), on the other hand, typically serve wealthier families with assets over $500 million, managing bespoke and often more complex needs. Many of the capabilities are in-house with some solutions and services being outsourced.

With growing wealth and impending generational transitions, Canadian families are increasingly recognizing the need for a more structured, sophisticated approach to managing not only their financial affairs but also the human and relational dynamics within the family. Professionalizing the family office – whether through dedicated in-house teams or leveraging outsourced specialists – has become essential in preserving multi-generational wealth.

A new era of professionalization of family offices

Whether a family is served by a SFO or MFO, these entities can offer a comprehensive range of expertise across critical areas such as:

- Tax strategy
- Legal, estate, trusts and wills
- Family dynamics and governance
- Wealth and investment strategy
- Philanthropy, giving and social impact
- Risk management
- Accounting, reporting and administration

Family offices don't just manage wealth – they often engage in multi-generational planning and support the build of legacies by integrating financial priorities with the family's broad goals, values and long-term ambitions.

Diversifying and protecting wealth in a changing landscape

As major players in the global and Canadian financial markets, family offices manage significant sums of capital. Their investment strategies span public markets, real estate, private equity, private credit, infrastructure, angel investing and venture capital. This diversity allows them to navigate evolving market conditions with agility while focusing on long-term sustainability.

Private market opportunities are particularly appealing to family offices, with alternative investments becoming key to portfolio diversification. According to Goldman Sachs' global report, "Family Office Investment

Insights: Eyes on the Horizon," family offices surveyed allocate a significant portion of their investments to alternatives, with nearly half (44 per cent) of family office portfolios in these assets[1].

Family offices today are focused not only on maximizing financial returns but also on ensuring their investments align with broader social and environmental missions. Whether through impact investing or philanthropy, wealthy families are increasingly emphasizing the importance of purpose alongside profit.

Preparing for historic wealth transfers

Canadian family offices are reaching a pivotal moment as they prepare for one of the largest intergenerational wealth transfers in history. Over the next two decades, Baby Boomers will transfer trillions of dollars to their heirs, fundamentally reshaping family businesses and wealth landscapes.

This impending wealth transfer also brings an expected rise in M&A activity and the transition of family-owned businesses. Family offices serve as a critical ecosystem for managing these transitions, allowing families to preserve their legacies while adapting to new ownership or leadership structures. The ability to strategically plan for these transitions, while navigating complex tax and estate considerations, underscores the importance of professionalizing family offices.

Rising wealth consciousness among next-gen family members

As wealth transfers to the next generation, a shift in priorities is emerging. Younger family members are more focused on social and environmental impact, prioritizing sustainability and responsible investing. This rising "wealth consciousness" reflects a growing recognition that great wealth comes with responsibility.

Next-gen family members are increasingly involved in shaping their family offices to reflect these values, with an emphasis on philanthropy, impact investing, and socially responsible business practice. For many, this shift isn't just about managing wealth – it's about leaving a lasting positive impact on society.

Choosing the right family office structure

Given the diverse and long-term goals of wealth families, family offices can take several structural approaches depending on their size, resources, and complexity. These approaches generally fall into three categories:

1. **Fully in-house management**
   This model involves a dedicated team of professionals who manage the family's wealth internally, offering complete control and customization. However, it can be costly due to higher staffing, compensation and infrastructure needs.

2. **Fully outsourced management**
   Families may opt to outsource financial and investment management to external advisors, which provides access to best-in-class experts without the burden of maintaining an in-house team full-time. The downside is less direct control over decision-making.

3. **Hybrid model**
   A blend of in-house and outsourced strategies, the hybrid model allows for flexibility and access to external expertise while maintaining a core team of internal professionals. This structure is cost-effective and adaptable but requires careful coordination between internal and external resources.

Expanding the scope of family office services

Family offices provide a broad spectrum of services to help families achieve their multiple goals and objectives. These services range from tax planning and legal support to family governance, succession planning and philanthropy. Each service is tailored to meet the unique needs of the family, ensuring both the long-term prosperity and harmony of the family enterprise.

Business and Family Goals	Family Office Services
Tax strategy	• Cross-border and international tax • Income taxes and probate • Luxury assets • Restructuring and optimization • Tax compliance • Tax planning
Legal, estate, trusts and wills	• Estate planning • Incapacity planning • Legal services • Liquidity and insurance planning • Shareholders' agreement • Trusteeship
Dynamics and governance	• Communication and conflict resolution • Continuity and succession planning • Family board advisory • Family dynamics • Family learning and education • Governance • Meeting facilitation and retreats • Family dynamics • Family learning and education • Governance • Meeting facilitation and retreats
Wealth and investment strategy	• Consolidated reporting • Debt and financing strategy • Direct investments, co-investments, venture capital • Financial planning, cashflow and budgeting • Investment strategy • Market analysis • Portfolio review • Research, due diligence and asset allocation • Socially responsible investing (SRI); environmental, social, and governance (ESG) and impact investing
Deal advisory	• Acquisition and disposition planning • Business valuation • Corporate finance • Mergers and acquisitions (M&A) • Rapid performance improvement

Business and Family Goals	Family Office Services
Philanthropy and impact	• Due diligence, impact assessment and evaluation • Family foundations • Next generation education and engagement • Socially responsible investing • Strategy, planning and governance • Values, vision and goals setting
Risk management	• Cybersecurity • Information technology (IT) environment protection • Privacy, identity, reputational protection • Regulatory compliance and monitoring • Third-party risk management
Accounting, reporting and admin	• Administration • Art/collections management • Bill payment coordination • Bookkeeping and accounting • Document management • Lifestyle management • Luxury assets management • Measurement and evaluation • Oversight and monitoring • Tax compliance

Source: KPMG in Canada

Looking forward: Professionalization and future-proofing family offices

With minimal regulation in the family office sector in Canada, professionalization is becoming increasingly critical – not only to navigate current complexities but also to prepare for potential future regulations. By building strong governance frameworks, documenting policies and ensuring alignment between family values and wealth management, family offices are positioning themselves for resilience and growth.

As the world faces transformation changes – from the rise of artificial intelligence to the shift toward a low-carbon economy – Canadian family offices are well-poised to lead in both economic and social innovation, ensuring that wealth is managed responsibly for generations to come.

1 Goldman Sachs, "Family Office Investment Insights: Eyes on the Horizon", May 2023.

7

The Landscape of Retail Distribution of Private Market Investments in Canada

By: Lillian Ferndriger

Director, Alternatives Distribution, BMO Global Asset Management

BMO Global Asset Management

Canada is internationally known as a pioneer of private market investing. Institutionally, our "Maple 8" pension plans invest up to 60% of their assets in alternatives allowing Canadians to enjoy the benefits of private market investing throughout the years.[1] However, this has not particularly translated into individual Canadians' portfolios. When we look to the high net worth space in Canada, the average client has less than a 3% allocation to alternatives. [2]

Although Canada has made strides through our liquid alternative mutual funds, private market investing is generally available through confidential private offering memorandum (OM). There has been increased adoption of alternative investing through liquid alternative mutual funds, but the limit for private market investment is a maximum 15% of the fund's net asset value (NAV) at any time. As regulatory and financial innovation continue to occur, hopefully it will provide a more streamlined and easier way for Canadians to access private markets in their personal portfolios.

The landscape of retail distribution of alternative investments in Canada presents a dynamic and evolving market, characterized by distinct trends and challenges. By understanding the key aspects that influence the distribution and adoption of alternative investments, we can work towards making alternatives a more significant and accessible component of investors' portfolios.

Manufacturer-Driven vs. Dealer-Product Models

In Canada, the distribution of alternative investments is predominantly influenced by two models: the manufacturer-driven model and the dealer-product model. The manufacturer-driven model involves investment product manufacturers, such as asset management firms, creating and distributing their own alternative investment products. These manufacturers leverage their experience and resources to market their products to the intermediary channel (advisors) who then purchase the investments for their high net worth (HNW) clients.

For Manufacturer driven products, the asset manager decides between building in house product with internal capabilities or using the partnership/sub advised model to bring outside managers to market. Both ways have their advantages. By building products in house, the portfolio management, and in turn management fees, remain with the product provider. By using the sub advised model, proven track records and marketing capabilities can be used but fees are shared. The benefit to the manager is that they outsource the investment function, and the sub advisor benefits from the distribution team and channels of the manufacturer they've partnered with. However in Canada, manufactured products go through a rigorous approval process at each Dealer to allow distribution through their advisors.

On the other hand, the dealer-product model involves investment dealers creating bespoke alternative investment products from various manufacturers on an exclusive basis for their own channel. These products predominately have been closed end in nature with large international managers manufactured through a global fintech platform. The exclusive nature of these products per dealer is attractive to the high net worth (HNW) segment of the market and provide advisors with a competitive advantage over advisors at other dealers.

This dual source model seemingly provides investors with access to a broader range of products and allows financial advisors to tailor their recommendations based on the specific needs and preferences of their clients. However, this model can also lead to increased complexity and fragmentation in the market, as the access to private market product is a function of the dealer with which the advisor is affiliated.

Market Fragmentation and Distribution Challenges

The distribution of alternative investments in Canada is characterized by significant fragmentation, with a multitude of players involved in the creation, distribution, and management of these products. This fragmentation presents several challenges for both manufacturers and dealers. For manufacturers, gaining visibility and market penetration can be difficult, particularly for smaller firms or new entrants. They must compete with established players and navigate stringent dealer requirements to ensure their products are approved for sale while attractive to retail investors. Dealer requirements include assets under management (AUM) thresholds, operational due diligence scrutiny, and investor demand. In general, private market investments are deemed high risk by the dealer and certain dealers cap the amount of alternatives allowed in a portfolio. Some dealers have limits on the percentage amount within a portfolio to which a single product or a single manufacturer can allocate. The risk rating and capacity constraints hinder penetration.

For dealers and financial advisors, the challenge lies in selecting the right products from a diverse and constantly evolving market. The due diligence process for both dealer approval and advisor selection can be time-consuming and resource-intensive, requiring a deep understanding of the underlying assets, investment strategies, and risks of each product. Additionally, advisors must adhere to their Know Your Product requirements and ensure that their recommendations align with their clients' risk profile [3] and investment objectives while ensuring that the investor understands the underlying investment they are purchasing.

Increasing the Adoption of Alternatives in the HNW Sector

Despite these challenges, there are several strategies that can help increase the adoption of alternative investments among high-net-worth (HNW) individuals in Canada. First, enhancing education and awareness is crucial. HNW investors and their advisors must be well-informed about the potential benefits and risks associated with alternative investments. This can be achieved through targeted educational programs, industry conferences, and thought leadership publications that provide in-depth analysis and insights into the alternative investment landscape. AIMA is an educational resource for members with due diligence guides, regulatory advocacy and a steady source of educational webinars and conferences. According to the Chartered Alternative Investment Analyst (CAIA) website, the CAIA charter program is available for professionals who want to develop a deep level of knowledge in alternative investments and their contribution to the diversified portfolio. There are many resources available dedicated to education of alternative and more specifically private market investing.

Second, leveraging technology can streamline the distribution process and improve accessibility. Digital platforms can provide a more efficient and user-friendly way for advisors to complete the onerous paperwork required for an OM product.   Some platforms can offer personalized investment recommendations, portfolio management tools, and performance tracking, making it easier for advisors to incorporate alternative investments into their portfolios.

Third, innovation in product structuring will allow more access to private market products. The traditional closed end model is operationally intensive requiring capital calls, no liquidity for investors and a generally a long time horizon. The more retail friendly version of evergreen private market investment can allow for registered account eligibility (which can be subject to specific conditions) and access to more liquidity than a traditional closed end fund, with notice encouraging more HNW investors to purchase. This solves for some of the complexity of traditional closed end products making it easier for an advisor to add to an allocation model.

Conclusion

The retail distribution of alternative investments in Canada presents both opportunities and challenges for manufacturers, dealers, and investors. By understanding the dynamics of the manufacturer-driven and dealer-product models, addressing market fragmentation, and implementing strategies to increase adoption among HNW investors, we can unlock the full potential of alternative investments in Canada. Through education, technology, and innovation, the industry can create a more cohesive and efficient market that delivers value to investors and drives modernization in the financial services sector.

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1 Bain & Company, Global Private Equity Report 2023; Preqin, GlobalData
2 Bain & Company, Global Private Equity Report 2023; Preqin, GlobalData
3 Risk Profile - Comprised of a client's risk tolerance (i.e. client's willingness to accept risk) and risk capacity (i.e. a client's ability to endure potential financial loss)

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Trend Driving Alternatives Allocation in Canada

By: David Sum
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By: Michael Kim
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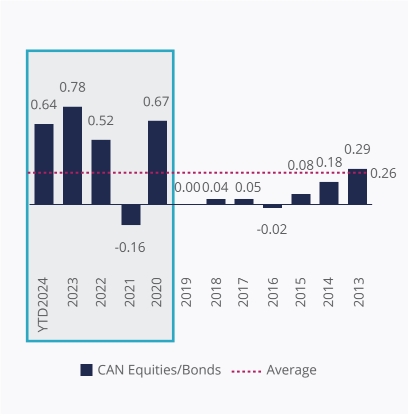
Are Stocks and Bonds Correlated?

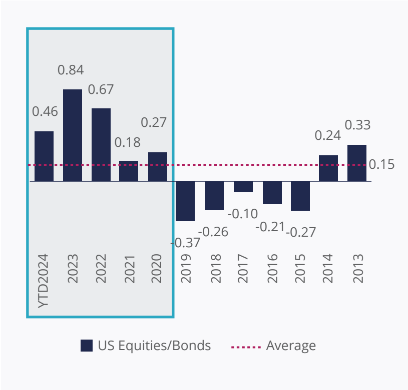
Historically, investors have had exposure to traditional asset classes such as public equities and fixed income. Why? They have been viewed as effective tools for diversification, offering both capital appreciation and income. This view is well founded, as long-term data reveals a low correlation between the two, enhancing their role in a balanced investment strategy.

However, in recent years, there has been a noticeable trend toward increasing correlation between traditional portfolio exposures, particularly between US and Canadian equities and fixed income. In particular, over the recent period of elevated rates, equities and fixed income have failed to deliver the diversification benefits that investors have historically relied on. For example, the correlation between Canadian equities and fixed income surged from 0.00 in 2019 to 0.67 in 2020. This positive correlation persists today.

CAN Equites/Bonds Correlation



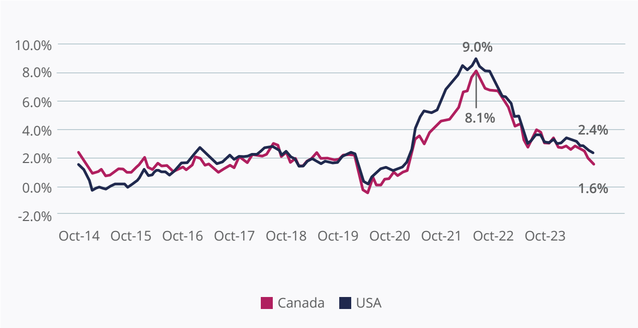
Correlation



Source: Refinitiv, as of September 2024. Benchmark indices represented as: US equities: S&P 500, CAN Equities: S&P/TSX Composite, US Bonds: Bloomberg US Aggregate, CAN Bonds: Bloomberg Canada Aggregate

Has Inflation Uncertainty Impacted Portfolio Diversification?

The notable impact of fiscal and monetary policy has transformed the relationship between traditional asset classes and the way investors allocate capital. With an unprecedented influx of stimulus into the economy, there has been a rise in inflation uncertainty. While inflation has reached a more normalized path, reaching 2.4% in the US and 1.6% in Canada, it has taken drastic measures including unprecedented rate hikes to do so. Coupled with ongoing geopolitical tensions, elections and disputes over fiscal and monetary policy, it is increasingly difficult to anticipate how these factors will affect portfolio diversification, returns, and allocations in the future.



Source: StatsCan, US Bureau of Labor Statistics: CPI

Are Investors Allocating to Alternatives?

In addition to the aforementioned uncertainty, public markets have become extremely efficient, making it challenging to generate excess returns. Alternatives can complement traditional equity and fixed income portfolios by providing diversification, lower correlation, capital appreciation and yield. For example, when comparing the traditional 60/40 portfolio to a 40/30/30 portfolio that includes an allocation to alternatives, it becomes evident that alternatives contribute to better risk-adjusted returns.

Portfolio Allocation	Annualized Return	Volatility
60% Equities / 40% Fixed Income / 0% Alternatives	8.7%	9.7%
40% Equities / 30% Fixed Income / 30% Alternatives	9.1%	7.9%

Source: JPMorgan: Guide to Alternatives Q3 2024. Portfolio data from Jan 1, 1990 - Mar 29,2024 indices represented: Alts include hedge funds, real estate, and private equity, with each receiving an equal weight. Portfolios are rebalanced at the start of the year. Equities are represented by the S&P 500 Total Return Index. Bonds are represented by the Bloomberg U.S. Aggregate Total Return Index. Volatility calculated as the annualized standard deviation of quarterly returns.

Institutions have embraced alternatives for some time, and in recent years, this has only continued. According to Preqin's Institutional Allocation Survey, from 2019 to 2023, institutions increased their alternative allocations from 15% to 20%.[1] Many Canadian pension funds have even larger allocations, with some over 50%. While this does not suggest that retail investors should adopt such significant allocations - given differences in investment objectives, funding capabilities, and asset-liability matching - it highlights the importance of having some exposure, as many investors remain underinvested in this area. Households with assets between $1 million and $5 million only allocate 1% of their net worth to alternatives in contrast to those with assets over $30 million, with an allocation of 19%.[2] As traditional securities become increasingly correlated and excess returns scarce, both institutions and savvy investors are likely to seek opportunities in alternatives. However, it's crucial to approach alternative investing with caution. That said, taking that first step is often the most important one.

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1 Preqin: Institutional Allocation Survey 2024
2 Forbes: KKR and Alterantives Industry Race for Individual Investors

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Hedge Funds & Canada

By: Kimberley Jansen

Managing Director, BMO Capital Markets

By: Sadia Quraishi

Director, BMO Capital Markets

What is a Hedge Fund?

A hedge fund is an investment vehicle that pools capital from accredited or institutional investors, typically managed by an asset manager or registered investment advisor. In Canada, these funds are structured as pooled investment vehicles, commonly established as Limited Partnerships or Trusts, and can be either onshore or offshore. The primary objective of a hedge fund is to deliver higher-than-average returns that are typically inaccessible to retail investors. Fund managers raise capital from external investors and deploy it according to a specific strategy. Hedge funds frequently engage in speculative activities such as trading derivatives, short selling, and employing leverage to enhance returns or mitigate risk.

Who Can Invest in Hedge Funds?

Hedge funds are typically not accessible to the general Canadian public retail investors and are only available to accredited investors, as defined by provincial securities regulators. Accredited investors generally include high-net-worth individuals, institutional investors (like pension funds and insurance companies), and entities meeting certain financial criteria. To qualify, individuals must meet specific income or asset thresholds, such as earning over $200,000 annually or holding $1 million in financial assets (excluding real estate). These investors must also be comfortable with complex strategies such as derivatives trading and short selling, which aim to maximize returns and manage volatility. Consequently, a significant portion of the retail investing community does not meet the eligibility criteria defined by the Canadian regulators.

Investor Access to Hedge Funds

In Canada, Funds are regulated by provincial securities authorities, with the Ontario Securities Commission (OSC) being a key regulatory body. The majority Canadian hedge funds are sold to investors by fund managers through an offering memorandum (OM). These managers often rely on the offering memorandum (OM) exemption, which allows them to raise capital from investors without the need for full public disclosure or a prospectus. This exemption makes it easier for accredited and sophisticated investors to access hedge funds. The OM provides investors with key information about the hedge fund's terms, risks and strategies. Typically, key terms such as leverage, concentration, redemption terms are wider, and very broadly defined relative to Prospectus based funds.

There are various distribution channels for Investors to access hedge funds in Canada. Some of these include; 1) Direct sales - largely used by institutional level managers/investors, 2) Investment Advisors - the bulk of which work for bank owned organizations and 3) Private Wealth management firms or platforms that cater to high-net-worth individuals and institutional investors. These platforms offer access to a curated selection of alternative investment products, including hedge funds, that align with specific investor risk profiles and return objectives.

Canadian Demographic

Asset concentration in Canada is well-diversified. Recent Preqin data values the Canadian hedge fund industry at approximately US$77B in AUM with 246 hedge funds across 130 managers. Only a handful of firms in the $1B+ in assets category (40% of Canadian hedge funds AUM<$150million). Long/short equity, equity market neutral and long/short credit remain the most popular strategies, though event-driven and multi-strategy follow closely behind.

The hedge fund landscape in Canada is a small yet significant part of the global hedge fund industry. Canadian hedge funds face increasing competition from larger, more established funds in the U.S. and global markets, which may have more resources and access to a broader range of investment opportunities. However, with increasing cross-border investments and globalization present opportunities for Canadian hedge funds to expand into larger markets and diversify their portfolios.

Fee Structure

Fee structures are often made up of a management and incentive/performance fee. Canadian fund managers face the same pressure to lower fees as managers in larger markets. Pressure to lower fees stems from various factors such as; increased competition, proliferation of lower costs products like ETF's and liquid alternatives and investor demand. The standard '2 and 20' fee model is transitioning into more of a bespoke arrangement between the fund manager and end client (for larger ticket sizes). While funds with 2% management fees and 20% performance fees are not uncommon in Canada, fee pressures from both institutional and retail channels are lowering the averages. The management fee is paid to the manager regardless of how the fund performs. The '2% fee' is based on the fund's net asset value (NAV).

The performance fee is paid out if the fund profits. There are a few ways a manager can charge this type of fee.

The performance fee can be calculated as a direct result of the fund's increase in NAV. 20% * net increase in NAV.

Similarly, the fee can be a direct result of the fund's increase in NAV, adjusting for the management fee. 20% * (net increase in NAV – 2% management fee).

Hedge funds often feature a "high water mark" provision in their fee structure to provide assurances to investors in the event the fund declines in value. If the fund is losing money, the manager must improve returns above this mark before receiving their incentive bonus. The fund must exceed the highest NAV it has previously achieved. Essentially this provision gives the investor the confidence that that performance fees are not paid on the profits that were just used to offset the losses from the prior year.

Hurdle rates serve a similar purpose. A manager can only collect his/her performance fee when returns are higher than this benchmark.

Investor Demand in Canada

Investor demand for hedge funds in Canada is driven primary by institutional and high net worth investors and is shaped by several factors: ranging from the stability of the financial system, the size of funds, external competition, the regulatory environment and the macro-economic climate.

Canada's robust banking sector and stable economy provide a solid foundation for institutional investors, such as pension funds, endowments, and insurance companies, to allocate substantial capital to hedge funds. These large investors seek alternative strategies to diversify their portfolios, reduce risk, and enhance returns. Hedge funds are particularly appealing due to their ability to use advanced strategies, such as short selling and derivatives, which can generate returns uncorrelated with traditional asset classes. Hedge fund demand from this investor base is concentrated in larger, well-established funds. These funds offer a stable capital base, making them more attractive to institutions looking for lower risk and higher liquidity.

Canadian hedge funds also face significant competition from U.S. and global markets. The Canadian hedge fund industry is relatively small compared to its U.S. counterpart. Many Canadian institutional investors allocate capital to U.S. or global hedge funds due to the wider variety of strategies and scale, which can make it challenging for Canadian hedge funds to attract significant local demand.

Niche strategies and challenges with Emerging Managers

Smaller hedge funds in Canada benefit from being nimble, allowing them to capitalize on niche opportunities which generally is a benefit of the Canadian landscape. There are several Canadian hedge funds that focus on niche strategies such as natural resources, which attract both local and some international institutional interest. Investors see this smaller hedge fund market as an opportunity to earn and generate strong returns in the niche strategies, as larger global funds may overlook these markets due to scalability issues.

Demand for emerging hedge fund managers in Canada remains limited to only high net worth investors rather than institutional investors. Canada lacks comprehensive emerging manager programs, with Quebec being the only province with a program dedicated to fostering local managers. Industry organizations, such as AIMA and EMB, continue to advocate for more support, but the lack of infrastructure makes it challenging for smaller funds to attract significant institutional investment. This limits the growth potential of new entrants in the hedge fund space.

Regulatory Environment

Canada's regulatory framework, while considered flexible compared to other markets, still maintains oversight that provides fund managers with a degree of freedom in their strategies. However, the burden of complying with multiple provincial regulators, heightened registration requirements, and complex documentation procedures makes launching new funds a lengthy and cumbersome process. More recently more stringent regulatory requirements have led to a decrease in new fund formations. These increased regulations drive up operating costs, further consolidating the market as larger funds establish stronger dealer relationships.

Another headwind lies in the distribution of hedge fund product to retail investors. The Canadian retail investor channel, dominated by CIRO investment dealer firms, is one of the key distribution channels for retail investor to purchase hedge funds. CIRO dealer firms (mostly Bank owned) have long overlaid additional independent internal risk rating policies for alternatives over and above all other regulatory guidance. This unfairly results in all alternative funds being rated as high risk, thereby limiting the number of investors who can access these products. AIMA and CAIA have introduced baseline risk rating guidelines for hedge funds to provide guidance for dealer firms to help streamline the rating process across different firms and across the Canadian marketplace.

Macroeconomic Climate

The higher interest rate environment in Canada, have made hedge funds less appealing to some investors, as safer alternatives like cash products offer relatively attractive returns and more liquidity. This can create a misalignment of expectations, with HNW investors expecting hedge funds to outperform in all market conditions. However, as interest rates begin to decline, some outflows may reverse, with capital returning to hedge funds as they once again become attractive for higher returns in a lower-rate environment.

SCOTIABANK CANADIAN HEDGE FUND INDEX

The Scotiabank Canadian Hedge Fund Index ended September 2024, up **0.70%** MOM on an asset-weighted basis and up **1.44%** MOM on an equal-weighted basis.

The Scotiabank Canadian Hedge Fund Index provides a comprehensive overview of the Canadian Hedge Fund universe. Returns are calculated using an equal-weighting and an asset-based weighting of the funds. The index includes open and closed funds with a minimum AUM of C$15 million and a 12-month track record, that are managed by Canadian-domiciled managers.

Index Summary

Month End Sep-24	Value	Return MoM	Return YTD	Ann. Vol**	Rolling 12 Mth	Sharpe Ratio^	Correlation to S&P 500^	Correlation to S&P/TSX 60^
Scotiabank Canadian Hedge Fund Index Asset-Weighted	3,506.45	0.70%	9.64%	7.77%	12.55%	0.64	0.29	0.58
Scotiabank Canadian Hedge Fund Index Equal-Weighted	2,623.95	1.44%	11.64%	7.75%	17.48%	0.44	0.58	0.80
S&P/TSX Composite Index	24,000.37	2.80%	14.51%	13.58%				
S&P/TSX 60 Total Return	4,825.53	3.05%	16.61%	13.15%	26.83%			
S&P 500 Price Return (USD)	5,762.48	2.02%	20.81%	15.09%				
S&P 500 Price Return (CAD-adjusted)	7,793.75	2.27%	23.38%	12.02%				
S&P 500 Total Return (USD)	12,608.07	2.14%	22.08%	15.03%	36.35%			
DEX 91 Day Treasury Bill Index	466.88	0.35%	3.80%	1.95%				
DEX Universe Bond Index	1,167.16	1.90%	4.31%	4.45%				

** Of monthly returns

Values are calculated monthly

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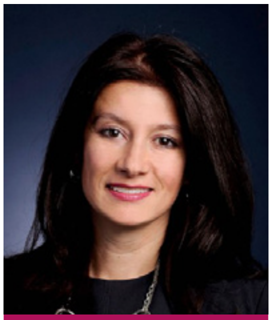
The Evolution of Liquid Alternatives in Canada



By: Vesna Dragic
Co-Head, Prime Brokerage, RBC Capital Markets

The Canadian Securities Administrators'("CSA") Investment Funds Modernization Project reviewed the parameters of product regulation that applied to publicly offered investment funds and was the initiative that brought liquid alternatives to Canada. It presented Canadian regulators with the opportunity to bring certain hedge fund strategies into a regulatory regime that allowed a broader group of investors to benefit from the incorporation of these strategies into an overall portfolio.

History

In 2013, the CSA published an outline of a proposed regulatory framework for alternative funds. In the following years there were a series of notices, comments, and industry meetings that shaped and re-shaped the rules for investment funds. Finally, in early 2019 the CSA introduced a new fund category - Alternative Mutual Funds - to its regulatory regime and brought liquid alternatives to the Canadian investment fund landscape.

The liquid alternatives regulations codified exemptive relief and clarified rules permitting innovation and flexibility in product development by asset managers. Innovations such as incorporating the regulatory framework for commodity pools, permitting borrowing and / or short selling up to 50% of NAV, and permitting investment in another NI 81-102 fund up to 100% of NAV facilitated the execution of hedging strategies and removed constraints to mitigating risk in fund portfolios. By exempting Liquid Alternatives from cash cover requirements, proceeds from short selling could be reinvested. Additionally, the clarification that the rehypothecation of assets held as collateral was permitted reduced costs for asset managers.

The evolution of liquid alternatives in Canada does not end with their launch in 2019. The period from 2019 to 2021 was particularly active for exemptive relief requests by asset managers. Various exemptive relief decisions related to portfolio strategy were granted, including:

Short selling relief: permitted funds to short sell greater than 50% of NAV

Cash borrowing relief: permitted funds to borrow cash up to 100% of NAV.

Leverage relief: allowed for the short selling of government securities up to 300% of NAV.

Purchase and Redemption Frequency Relief: permitted monthly purchases and monthly redemptions with 20 business days prior notice.

Exemptive relief was not limited to portfolio strategy related requests. The creation of liquid alternatives brought about the need to use a prime broker to provide financing and leverage.

Custodial relief: allowed a fund to use more than one custodian, which addressed the need to include in the fund's custody structure as a service provider with a financing facility.

Prospectus consolidation relief: allowed alternative mutual funds and non-alternative mutual funds to be included in the same short form prospectus.

Past performance relief: permitted a new alternative mutual fund to include in its sales communications the past performance of its non-prospectus fund under certain conditions.

Exemptive relief for these additional activities reflects the dynamic and adaptive nature of the liquid alternatives market.

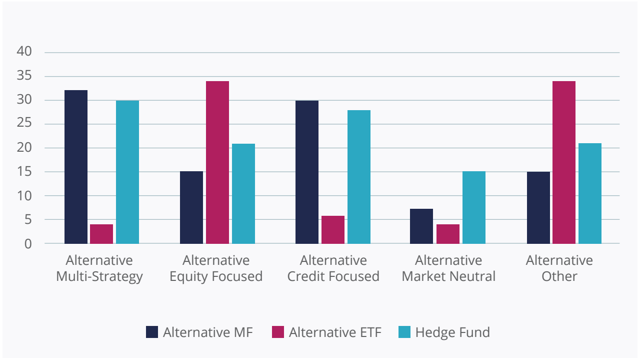
In 2022, the rules were updated to codify frequently granted exemptions related to documentation requirements, thereby reducing the regulatory burden for asset managers. The CSA continues to evolve regulations and has proposed amendments in 2024 to include crypto assets.

Growth

The largest hedge fund managers were the first to bring liquid alternatives to market. Their existing expertise with alternative strategies positioned them well to launch liquid alternative funds early on. Traditional asset managers hired experienced portfolio management teams that specialized in alternative investments in order to expand their product offering to include liquid alternative funds.

Liquid alternatives found greater acceptance than hedge funds in getting approved for distribution among dealers. Although barriers still exist to getting on dealer shelves due to the higher risk rating attributed to some fund strategies, the regulated and transparent nature of liquid alternative funds allows a broader range of wealth management clients to be able to access these products. In a few short years, the total number of alternative funds available in Canada is evenly divided between liquid alternative funds and hedge funds as of the end of December 2023.

Comparison of Alternative Funds by CIFSC Category

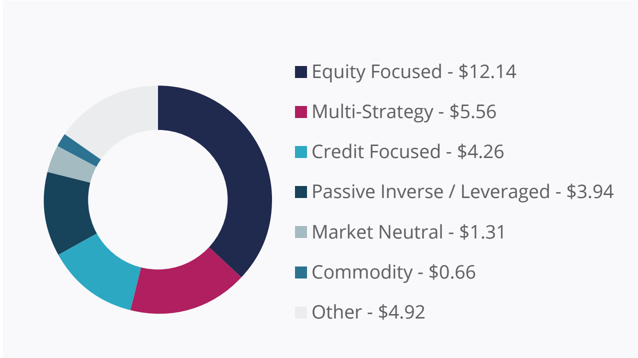


Source: AIMA Canada – FUNDATA Alternative Fund Statistics as of Dec 31, 2023 (number of funds)

2021 saw explosive growth and has by far been the best year for liquid alternatives in Canada, with over three times the net sales from the year before. The rate hike cycle that began in 2022 significantly impeded sales of liquid alternatives, however the trend is improving[1].

Liquid alternatives in Canada have grown to over C$32.8 billion in less than 5 years, with C$20.2 billion invested in 132 alternative mutual funds and C$12.6 billion invested in 122 alternative ETFs as of December 2023[1].

Liquid Alternatives Value by CIFSC Category Net Assets (billions)



Source: AIMA Canada - FUNDATA Alternative Fund Statistics as of Dec 31, 2023 (allocation data) and IFIC Investment Funds Report 2023 (total liquid alternative fund value data)

Liquid alternatives in Canada began as a fund modernization project that provided the opportunity for Canadian regulators to bring certain hedge fund strategies into a regulatory regime. It has since evolved into another asset class and democratized hedge funds by giving investors another tool to use in portfolio construction. The rapid initial pace of growth in liquid alternatives has slowed, but as alternative and traditional asset managers continue to launch new funds in the liquid alternative space, and as regulators continue to update rules in response to exemptive relief requests, the indications are that there is more meaningful growth ahead for this asset class in Canada.

[1] *Source: IFIC Investment Funds Report 2023*

Information sources:

IFIC Investment Fund Report 2023

AIMA Canada - Canadian Industry Data – FUNDATA Alternative Fund Statistics September 30, 2024

OSC – Final Amendments: Modernization of Investment Fund Product Regulation (Phase 2)

OSC - CSA Notice of Amendments - Modernization of Investment Fund Product Regulation - Alternative Mutual Funds

CSA – Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets

SCOTIABANK ALTERNATIVE MUTUAL FUND INDEX

The Scotiabank Alternative Mutual Fund Index ended September 2024 **up 1.27%** MOM on an asset-weighted basis and **up 1.36%** MOM on an equal-weighted basis.

Our index tracks the monthly equal-weighted performance of constituents classified as Canadian Alternative Mutual Funds, as defined by National Instrument 81-102. Given the emerging nature of liquid alternatives, there is no minimum track record, or AUM, required for inclusion in the Index at this time. We now track the performance of 85 funds, split between equity and credit-focused strategies. Two funds were added in September 2024†. New constituents are added as the market grows.

Index Summary

*Month End September 2024	Value	Return MoM	Return YTD	Rolling 12 Mth	Sharpe Ratio^	Correlation to S&P 500^	Correlation to S&P/TSX 60^
Scotiabank Alternative Mutual Fund Index Asset-Weighted	1,245.81	1.27%	8.78%	12.29%	0.36	0.84	0.82
Scotiabank Alternative Mutual Fund Index Equal-Weighted	1,315.26	1.36%	8.91%	11.85%	0.49	0.85	0.89
*Scotiabank Alternative Mutual Fund Index Equity Focused	1,387.20	1.20%	10.60%				
*Scotiabank Alternative Mutual Fund Index Credit Focused	1,146.13	1.01%	6.06%				
S&P/TSX Composite Index	24,000.37	2.80%	14.51%				
S&P/TSX 60 Total Return	4,825.53	3.05%	16.61%	26.83%			
S&P 500 Price Return (CAD-adjusted)	7,793.75	2.27%	23.38%				
S&P 500 Total Return Index (in USD)	12,608.07	2.14%	22.08%	36.35%			
DEX 91 Day Treasury Bill Index	466.88	0.35%	3.80%				
DEX Universe Bond Index	1,167.16	1.90%	4.31%				

^Values are calculated monthly
*Asset-Weighted

IMPORTANT NOTICE AND DISCLAIMER: The Bank of Nova Scotia ("Scotiabank") calculates and publishes the Scotiabank Alternative Mutual Fund Index (the "Index") at its own expense. It is prepared solely as an information service to financial market participants and is published on a best-efforts basis. Scotiabank and/or its affiliates do not recommend, express any opinion or accept any liability regarding the constituent funds or their respective holdings by virtue of their inclusion in the Index. The data used to construct the Index is provided on a voluntary basis by the constituent mutual funds and is not reviewed, audited or independently verified in any way by Scotiabank and/or its affiliates.

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Canadian Alternative Fund Performance

Alternative Credit Focused									
	1 Yr			3 Yr			5 Yr		
	Average	Max	Min	Average	Max	Min	Average	Max	Min
Annualized Return	10%	16%	3%	4%	12%	0%	5%	15%	1%
Standard Deviation	3%	8%	0%	4%	8%	0%	8%	15%	1%

Source: Fundata, as at Jun 30,2024.

Alternative Equity Focused									
	1 Yr			3 Yr			5 Yr		
	Average	Max	Min	Average	Max	Min	Average	Max	Min
Annualized Return	8%	53%	-51%	-3%	35%	-31%	5%	27%	-11%
Standard Deviation	16%	38%	2%	16%	38%	2%	18%	36%	5%

Source: Fundata, as at Jun 30,2024.

Alternative Market Neutral									
	1 Yr			3 Yr			5 Yr		
	Average	Max	Min	Average	Max	Min	Average	Max	Min
Annualized Return	8%	14%	0%	4%	17%	-6%	5%	11%	-2%
Standard Deviation	5%	14%	1%	5%	17%	1%	7%	18%	4%

Source: Fundata, as at Jun 30,2024.

Alternative Private Debt									
	1 Yr			3 Yr			5 Yr		
	Average	Max	Min	Average	Max	Min	Average	Max	Min
Annualized Return	1%	13%	-62%	3%	12%	-56%	12%	11%	-36%
Standard Deviation	5%	52%	0%	4%	45%	0%	3%	37%	0%

Source: Fundata, as at Jun 30,2024.

Alternative Private Equity									
	1 Yr			3 Yr			5 Yr		
	Average	Max	Min	Average	Max	Min	Average	Max	Min
Annualized Return	2%	16%	-12%	4%	13%	-2%	6%	14%	0%
Standard Deviation	4%	17%	2%	6%	25%	1%	6%	21%	2%

Source: Fundata, as at Jun 30,2024.

Maximum Drawdown (MaxDD)						
	1 Yr		3 Yr		5 Yr	
	Average Max DD	Largest Max DD	Average Max DD	Largest Max DD	Average Max DD	Largest Max DD
Alternative Credit Focused	-1%	-4%	-6%	-10%	-13%	-30%
Alternative Equity Focused	-11%	-52%	-30%	-69%	-32%	-69%
Alternative Market Neutral	-2%	-11%	-6%	-23%	-11%	-32%
Alternative Multi-Strategy	-4%	-28%	-10%	-44%	-16%	-49%
Alternative Private Debt	-5%	-63%	-6%	-92%	-7%	-92%
Alternative Private Equity	-4%	-12%	-7%	-16%	-8%	-16%

Source: Fundata, as at Jun 30,2024.

Multi-Strategy had the best average 1 year performance at 12.2%. Credit Focused had the second best at 9.7% but also had the lowest volatility at 3% and the smallest average drawdown at under 1%. Equity Focused had an average gain of 8.4%, however it was the most volatile category and within the category, fund performance ranged from a high of +53% to a low of -51%.

Over the 3 year period, Credit Focused had the best average return at 3.8% and the smallest average drawdown at just 6.2%. Equity Focused had a negative average return over this period, losing 3.2%. It also had the largest average drawdown at 30%.

Looking at the 5 year numbers,PrivateDebtledthe way with an average return of 12.2% and a standard deviation of just 3.2%. Market Neutral had an average return of just 4.7% but had the smallest average drawdown of the non-private funds at 10.6%.

*Data as of June 30th. Universe includes exempt market funds in the Fundata database. Does not include alternative mutual funds or ETFs.

FUNDATA

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The Private Debt Era

By: Belle Kaura
Former Chair of AIMA Canada (2018-2024) and AIMA Global Council member (2022-2024)

Vice-President Legal, Chief Compliance Officer

THIRD EYE CAPITAL

The Private Credit Advantage

Private credit ("PC") fuels companies of all shapes and sizes with vital capital, offering flexible be-spoke financing solutions to fit the type of transaction and timing borrowers need, whereas banks are constrained by rigid conventional criteria and regulations. PC can provide tailor-made rescue capital to underserved businesses, SMEs, and companies undergoing transitional change, that banks cannot. Against the backdrop of tighter bank lending and recession fears PC provides speed of execution and pricing certainty. Direct lenders act as strategic partners contributing more than simply capital, borrowers can leverage their operational and re-structuring expertise. A holistic investment approach supports the real economy by fostering a dynamic ecosystem that stimulates innovation and expansion.

Institutional and retail investors are increasingly allocating to PC for higher yields than traditional fixed income strategies, lower loss rates than public credit, and as a shelter from public market volatility. PC is a diversifier that can provide income, illiquidity premiums, and act as a hedge against inflation to provide better risk-adjusted returns. Custom portfolio construction across different types of PC strategies can serve to blend risk-adjusted returns. Floating rate loans provide real-time interest rate mitigation, unlike fixed rate bonds. Historically, PC performance has generated compelling returns as compared to fixed income. Since the GFC, direct lending has delivered capital preservation, lower volatility, and higher returns than both high-yield bonds and leveraged loans.

Exponential growth over the past decade has propelled PC to overtake venture capital to become the second largest private market strategy by annual fundraising after private equity. There are currently over 1,100 private debt funds in the market, with 60% in the US. There is a paradigm shift away from private equity to PC which offers security of senior secured positions and attractive returns. PC is in the strongest position since the GFC, accounting for half of global financial assets due to the highest interest rates seen in four decades, a retrenching movement by banks, and greater demand for capital than supply. Once a niche asset class, PC is forecasted to hit $2.8 T by 2028, a steep rise from $1.5 T at the beginning of 2024. Investor appetite remains strong with no signs of abating with 92% of investors planning on adding to their PC positions over the next 12 months. Supporting this momentum is the global private debt fund rolling one year IRR of 9.2% for 2023, making it the second strongest strategy behind private equity at 10.5% return. Last year was an exceptionally strong performance year for private debt with floating rate loans. Current yield of directly originated middle market loans is 10.95%. The average fund size of closed funds has risen to $1.5Bn with global mega funds continuing to dominate.

Fundraising and Strategy Preferences

Direct lending stands out as the strategy of choice capturing 70% of LPs interest and surpassing $540 B in 2023, a steep rise from $70.8 B 10 years ago. Fund raising picked up in Q2 to $50.4 B as interest rate expectations solidified with 88% of capital raised ear-marked for direct lending. However, the direct lending growth rate is tapering as other strategies (ie. mezzanine, infrastructure debt) burst onto the scene, constituting only 31.8% of 2023 fundraising compared to half in 2021. Pure distress strategies tailed off from the 5-year average of 15.3% to 11. 2% as workouts pre-empt distress fund involvement. Meanwhile special credit situations saw ele-vated fundraising at 15%. In emerging strategies, 58% of LPs preferred asset-backed lending and 37% private debt secondaries. Per-formance met or exceeded expectations of 86% of investors, 63% expect continued strong performance over the next 12 months, while 30% expect even better performance. An overwhelming proportion of investors (89%) expect the US to see the best opportuni-ties, an increase from 78% in 2023. Growth of the asset class is evident in core and developing markets around the world.

PC has earned a place in institutional portfolios with almost one third invested, two third allocating upwards of 5%, and investors targeting allocations of 8-14%. Better downside protection than equities and higher returns than traditional income is driving pen-sion plans and insurers into the asset class. Globally, institutional flows exceeded $200 B for the 4th consecutive year. Many of Can-ada's largest pension plans are expanding into PC and ramping up internal asset-based lending groups as banks curb their risk ap-petite and economic uncertainty lingers. There is runway for managers as Canadian institutions remain relatively under-invested in PC as compared to the US and some pensions continue to be managed externally. Six of Canada's largest pension plans, collectively managing $1.3 T, launched a strong foothold into PC with plans to significantly increase their exposure. CPP Investments plans to double its credit portfolio to $115 B over the next 5 years with PC being a key part of their strategy. By the end of 2022 CPPIB had $44.4 B in PC, representing a 25% year-over-year increase. Pension Investment Association of Canada invested 5.4% of their portfolio in PC in 2022, up from 3.7% in 2021, and British Columbia Investment Management has surpassed $13.5 B.

Retail investors must have access to PC to help them meet their financial goals, especially in Canada as only 40% of the 5 million Canadians retiring by 2025 have a pension plan. A balanced portfolio in the new normal merits an allocation to PC of between 5 to 20%. Unlike south of the border, where larger managers are penetrating non-traditional funding and accelerated growth is anticipat-ed due to untapped retail sector opportunities, retail allocations in Canada have chilled somewhat due to shockwaves associated with one bad actor a few years ago that instilled reticence across bank-owned dealers. This phase is expected to pass as managers with proven strategies hold steadfast and deliver on fundamentals. Canadian boutique and traditional managers offer innovative retail-friendly products with differing risk return profiles. PC is often associated with higher inherent risk, even though it spans all parts of the capital structure and has varying risk profiles. To de-bunk this myth, expanded democratization will require dealers to play a pivotal role in broadening distribution channels and implementing robust due diligence of a managers' investment and oper-ational risk management processes, valuation methodologies, and liquidity terms and effects in unusual or stressed market condi-tions.

Canadian Market Dynamics

Post-GFC there has been an evolutionary shift from banks to private lenders who are stepping in to fill the widening void. This phenomenon is more pronounced in the US as credit in Canada has historically been dominated by the big banks. Approximately, 80% of annual loans in Canada are by banks as compared to only ~20% in the US. There is limited competition with less than 3% of annual business loans in Canada being made by pooled investment vehicles, but that may now be changing as only 60% of the $1.43 T loaned Q4 2023 was attributable to Canadian banks, with 40% coming from alternative lenders. The sectors of real estate, financial services, and retail comprise 60% of business loans and while Canada ranks 19th in the world in ease of access to business lending (US is 2nd) U.S. managers invest just 2-3% of their deals in Canada.

Banks are retrenching in the face of greater regulatory scrutiny, cost structures, and liquidity constraints. Financial authorities have universally enhanced supervisory activities of risk exposures. In the US banks need to free up regulatory capital to comply with tougher rules in the wake of Silicon Valley, regional bank crisis, and Basel III. The first major banking regulation reform in Canada in recent times increased capital requirements and raised the domestic stability buffer, when bank capital is already at a premium. Business lending indicators show significant bank tightening close to peak pandemic levels, with banks less willing to extend credit to non-PE sponsored SMEs involving complexity or undergoing change - which is creating a corollary increase in adoption of non-bank credit alternatives.

Canadian banks extended amortization periods and amended covenants through the pandemic and in 2023 to support businesses tackling a challenging inflationary environment. They are now taking a more cautious approach in light of uncertain economic conditions by increasing loan loss provisions to ~20% above pre-pandemic levels and maintaining large capital buffers to protect balance sheets in anticipation of credit defaults. Private lenders are following suit to improve their resiliency and strengthen liquidity risk management. The biggest segment of PC, direct senior secured lending, continues to have solid terms and covenants including at least two financial covenants. Further lending pressures and credit loss provisions are anticipated but are expected to peak in 2024. Caution by the Canadian debt market caused a slowdown in the loan issuance growth rate of 4% year-over-year (5% 2023; 9% 2022). This conservative approach relative to global banking peers in the US resulted in greater stability of the Canadian economy. While Canadian banks remain resilient and well capitalized with sufficient liquidity buffers, stress in the global banking sector akin to events of March 2023 could lead to a loss of investor confidence and deposit outflows. Banks could also be impacted by a disruption in global wholesale markets given their reliance on this source of funding. The position of Canadian banks makes a case in favour of alternative lending.

Over the course of the past year, tightening financial conditions, contraction in bank lending, and signs of business stress created a void in lending markets. While banks face regulatory and operational constraints, PC is a testament to the adaptive and innovative spirit of alternative lending which supports growth and innovation needed for businesses to survive and thrive. The rise of PC has made it an integral part of the financing ecosystem, serving to diversify the financing option landscape. The increase in choice and availability of financing by alternative lenders reduces systemic risk of over-reliance on the traditional bank sector, thereby contributing to financial stability and offering greater resiliency through banking crises or regulatory changes.

Credit and Insolvency Trends

Financial conditions and lending standards tightened to levels historically associated with recessionary periods. Capital supply growth is contracting as macro weakness put pressure on the credit environment. The combination of monetary tightening and floating rate loans added ~500 bps of interest expense, causing a 20% degradation in EBITDA. Inflation and more expensive debt coupled with enduring pandemic issues squeezed margins. Corporate distress is on the rise. Total credit to non-financial corporates as a percentage of GDP is 115% in Canada, higher than the U.S. (77%), EU (101%), and UK (67%). Since mid-2009, non-financial corporates have become more highly levered in Canada than in the US (Q1 2023 Canada DSR 52% vs 41% US).

Stress impacts of higher rates, slower economic activity, and catch-up effect of phasing out government intervention elevated insolvency rates. US Chapter 11 filings are 39% higher than 2023 and 46% higher than the past decade. Canadian insolvencies surged at record rates not seen in over two decades, increasing steadily since early 2022 and sharply since mid-2023. Bankruptcies were up 182% 2021 to 2023 and an astounding 70% year-over-year in the first half of 2024, double the pre-pandemic average. Insolvencies were expected to rebound to pre-pandemic levels but surpassed those levels by a large margin. Insolvencies are heavily concentrated among small businesses, and while broad-based across industries, sectors more vulnerable to economic disruptions (retail, hospitality, energy) were harder hit. SME's must remain vigilant as they are most vulnerable to higher debt servicing costs and slowing economic growth. This insolvency boom will have little impact on bank performance as such loans represent a small proportion of the total loan portfolios of banks.

Correlation Anomalies – Default Rate Relationship with Insolvency and Distress Debt

Default rates are a leading indicator of recessions and tend to mirror insolvency trends. Credit cycles have distinct stages (benign, average, stressed, crisis) characterized by varying levels of interest rates, default rates, recovery rates, liquidity, and returns. Based on this spectrum of credit market activity, we are in the "average" stage, whereas insolvency data and interest rates point to a "stressed" phase. Surprisingly, default rates are unusually low, below the 10-year average, despite skyrocketing debt servicing costs and bankruptcy figures. Low default rates in Canada are primarily due to bank forbearance from enforcement and relief through indefinite waivers and are exacerbated by a rise in negotiation of debt restructurings, which prevent immediate defaults and extend debt maturities. Default rates of senior secured debt are lower than other parts of the capital structure. The US is also experiencing low default rates as middle market companies posted positive year-over-year growth in sales and profits since the second half of 2023. Economic uncertainty persists on both sides of the border, but with the Bank of Canada well into its easing cycle and Federal Reserve rate cuts in September the higher-for-longer thesis is fading along with default risk. The focus is not just on the extent of rate cuts but also their timing and impact on credit conditions. The question is whether rate reductions can stabilize and eventually improve deteriorating credit conditions to keep defaults low. The outlook for the credit cycle is anything but normal.

The anomaly in the relationship between loan defaults and corporate insolvency rates is caused by the delayed impact of broader economic conditions. Effects of rising rates and economic downturns on default rates often lag initial triggers. The full impact of current economic conditions could manifest more clearly in the coming quarters. Recent Canadian bank earnings reports highlighted the idiosyncratic and unpredictable character of business loans. Some of the larger losses were related to commercial loans made during the pandemic, over three years ago. The massive delayed default cycle predicted post-pandemic did not materialize and is unlikely to materialize to the extent originally predicted as large scale defaults and distress scenarios were staved off as we have hit the peak of the stress and rates continue going down. PC proved its resilience through strong underwriting capabilities and the value of cooperation with borrowers, as evidenced by low defaults and good performance through a period of extreme difficulty.

High credit spreads and distress debt ratios are approaching pre-2008 crash and dot.com bubble levels. Indicators of financial stress were below historical averages through the pandemic but are normalizing. The distress debt ratio is a common indicator of potential future default activity. Over the past year, the positive correlation between default activity and distress debt in the corporate credit market has broken down. The primary reason being the tremendous volume of capital with trillions of dollars of surplus capital since the pandemic created by Central Bank reserves. There is a mismatch in supply and demand and the substantial capital raised for investment in direct lending. Earlier this year when corporate defaults were rising there was still very little pricing at distressed levels. Secondary market prices can no longer be relied upon. The marked disconnect in the standard correlation between distress debt ratios and default activity is forcing greater examination of other key metrics to assess the state of the market (ie. maturities, leverage levels, cashflow data etc). Restructurings, amends, and extends can be a red flag. Traditional metrics no longer make sense in today's fast evolving and unique landscape. The post-pandemic era requires a more nuanced analysis of a company's ability to navigate credit markets and survive higher rates and pressure on margins. For a true picture, investors must turn to fundamentals instead of secondaries markets which typically inform the distress debt ratio. Unprecedented levels of liquidity support and central bank intervention over the past few years created cheap liquidity for fundamentally sound businesses causing overleveraged balance sheets and delayed impacts of underlying financial pressures. Distress scenarios today look very different than they did pre-2020, even when S&P distress definitions are met businesses can be operationally sound and have sufficient liquidity. These businesses are facing challenges refinancing debt as it becomes due. In this market environment, a deeper dive into earnings and cash flow generation is warranted.

Resilience of Canadian Market

The Bank of Canada Financial Stability Report 2024 affirmed the resilience of the Canadian financial system. Despite inflationary pressures, record high rates, geopolitical concerns, and real estate / construction slowdowns, Canada avoided a recession. Forecasted GDP growth is 0.9% for 2024 vs. 1.1% in 2023, while US GDP continues to grow at a steady pace of 1.4%. While inflation has impacted bottom-line profitability, surprisingly many SMEs, especially those in essential or resilient sectors, have managed to maintain stable cash flows and meet their debt obligations. Canadian businesses remained financially healthy due to diversified and long-term financing, reduction of credit demands, and higher levels of illiquid assets built up during the pandemic. Debt-to-asset ratios rose in 2023 due to lower asset valuations but remain below pre-pandemic levels. While liquidity positions deteriorated over the past 12 months, levels are still strong by historical standards. Borrowers in the US have also been able to successfully manage liquidity. Interest costs as a share of earnings remain below pre-pandemic levels but will keep rising if existing debt is refinanced at higher interest rates. Liquidity management came into sharp focus as financial system participants, including businesses, banks, and non-bank financial institutions adapted to challenges and proactively adjusted to higher rates.

Debt serviceability and asset valuations are key risks to financial stability. Risk indicators that are increasing more rapidly than others should be monitored. Valuations of some financial assets are stretched, increasing risks of a sharp correction that can generate system-wide stress. Recent rises in leverage in the non-bank financial intermediation sector could amplify the effects of such a correction. The interconnectedness of the financial system could result in stress in one sector having a contagion effect.

Anticipation of Central Bank reduction of policy interest rates is driving a renewed appetite for risk, raising financial asset prices and driving down risk premium and credit spreads in Canada and the US. The end of tightening is coming but will be unlikely this year as recent data signals economic slowdown and risk of liquidity pressures in the US financial system. Timing and pace of expected declines in policy interest rates remains to be seen as inflationary pressures could be higher than expected. The global economic and financial environment has improved over the past year with declining inflation and lessened risk of a major recession. However, uncertainty of geopolitical tension escalation could lead to a repricing of assets and lower global risk appetite. Recent forecasts of a US recession increased by 10% from 15% to 25%.

Outlook for Private Credit

The outlook for PC is promising. The Canadian PC market is expected to grow over the next 5 years across the institutional and retail space. Emerging opportunities for retail investors to realize on the growing demand for PC exist. Persistent inflationary pressures driving a high-rate environment, tightening bank conditions, liquidity constraints in the syndicated market, and evolving lending trends have had a favourable impact on PC. Higher rates raised borrowing costs and removed excess liquidity across the economy. These dynamics allow lenders to command enhanced deal terms, including lower leverage ratios, and better debt coverage metrics. Even as rates go down PC should continue to gain ground and perform given bank retrenchment and heightened regulation. While rate cutting will negatively affect yields on floating rate loans, returns should remain strong.

In recessionary periods or times of high default conditions, borrowers can turn to private lenders with experience in restructuring and navigating through downturns. PC vehicles that lock up institutional capital for a pre-determined extended duration allow PC to endure through credit cycles. Hybrid and junior capital may be needed as fundamentally sound businesses facing higher debt service levels maximized senior debt. In the lucrative world of private assets, direct lending has the potential to expand dramatically and grow into the private equity footprint ($5.2 T), particularly as bank lending declines and regulatory constraints rise. Private debt sponsors are ramping up asset backed financing, historically dominated by the banks, with a global market estimate of between $5-20 T.

Market uncertainty and tighter capital conditions drove a slowdown in M&A activity returning to pre-pandemic levels with a 35% decline in 2023, impacting investment exits and turn-arounds dependent on M&A synergies. This created pent-up demand for deals as businesses postponed going to market. A rebound in M&A is imminent, particularly for industries sensitive to economic slowdowns (healthcare, technology, food and beverage) as economic uncertainty lessens and rate cuts materialize which should be positive for private credit.

While US alternative lenders are increasingly active in Canada, domestic managers have runway to seize opportunities as they have the advantage of deep knowledge of Canadian markets and laws. Structural factors make Canada an inefficient lending market relative to the United States and other developed economies which creates attractive opportunities for home-grown direct lenders with scale, expertise, and local knowledge. More experienced managers will prevail over newcomers seeking to capitalize on robust demand for PC. There exist opportunities for private lenders to provide financing to high quality growth companies as equity investors shift away from growth companies to stable profitable companies.

The next growth phase will capitalize on macro themes of de-globalization, data/security, distress debt, digitization, and de-carbonization and launch of specialized industry-specific thematic, and situational credit solutions (ie. wholesale financing, cash flow lending, supply chain finance, leasing, project finance, energy transition). Rapid growth of the burgeoning PC sector will mean heightened scrutiny of policy makers and financial stability bodies that the asset class will need to get in front of.

Sources: Private Debt Q2 2024: Preqin Quarterly Update; 2. Bank of Canada Financial Stability Report 2024; 3. Morgan Stanley, Investment Management, June 20, 2024; 4. Q2 2024 TEC Investor Report and presentations, Arif Bhalwani; 5. Distressed Debt: The Default Disconnect, Jon Yarker, July 2024; 6. Pitchbook– Q4 2023 Global Fund Performance Report; 7. Q3-2023 Insolvency Statistics, Office of the Superintendent of Bankruptcy; 8. Canada's Top Pension Funds Pile Into Private Credit as Banks Retreat, Reuters, Jan.2024; 9. Q4 2023 Canadian Debt Market Report, BDO, Feb. 14, 2024; 10. Office of Superintendent of Bankruptcy, Insolvency Statistics, Q2-2024; 11. Guidelines for Investing in Private Credit, This unique, illiquid, asset class demands a risk-conscious approach, By: Michael Naim, August 30, 2023, Investment Executive; 12. Debt service ratios for private non-financial sector, BIS.org, March 2023; Pitchbook Global Private Debt Report 2023; 13. Cliffwater Direct Lending Index.

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Evolving Landscapes: The Rise of Syndication & Securitization in Canadian Markets

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INVICO

Canada has traditionally lagged in adopting institutional term debt financing, instead relying heavily on short-term revolving bank debt and equity financing. However, new Basel restrictions will limit the availability of traditional bank debt capital for Canadian corporations. This regulatory shift, combined with potential GDP growth headwinds and potential reductions in available equity capital, underscores the growing need for alternative capital solutions to maintain global competitiveness.

The Canadian debt capital market is on the brink of a transformation reminiscent of the post-Great Financial Crisis era in the U.S. when banks transitioned to an originate-to-syndicate model for corporate loans. This risk transfer from banks to non-bank institutions will offer Canadian corporations term debt solutions with predictable capital costs over multiple years. As a result, transaction flow in the middle market segment is expected to increase, presenting significant opportunities for institutional investors.

This evolving investment landscape is set to mirror the high-yield bond and syndicated term loan markets established in the U.S. After the Great Financial Crisis, changes in banking regulations made it costly for banks to hold below-investment-grade credit on their balance sheets. The solution was the originate-to-syndicate model, where banks offered small, super senior working capital facilities and transferred most of the term debt risk to institutional investors. This approach allowed banks to generate fees through placement and agency services, maintain borrower relationships, and de-risk their balance sheets.

The result is a positive feedback loop: corporations gain access to long-term capital, banks reduce risk, and institutions with expertise in pricing credit risk capture opportunities to deliver yield to their clients. Banks are then able to securitize these rated loans, providing institutions with capital through investment-grade portfolio financing. This process is further supported by institutional fixed-income trading desks, where banks can act as liquidity providers or market makers in the secondary market for these new securities. This shift benefits corporations and banks and creates a robust market for institutional investors, positioning Canada to leverage the strengths of its financial ecosystem and drive much-needed economic growth through innovative capital solutions.

Emerging Secondary Opportunities from Market Dynamics & Mispriced Risk

The transformation in Canadian debt capital markets brings about not only larger, syndicated investment opportunities but also secondary ones arising from market dynamics and mispriced risk. As direct lending remains an illiquid asset class, the recent surge in capital from investors with short-term horizons has exposed vulnerabilities in the private credit universe. Many Canadian private credit funds have not adequately prepared for redemption cycles, which will create significant opportunities in the coming years. These opportunities will stem from both deeply distressed loans and high-quality assets where risk was simply mispriced. During redemption periods, funds may raise cash by selling a portion of a loan in the secondary market, provided demand exists. Portfolio managers, aiming to avoid significant write-downs, typically start by selling performing, higher-quality collateral to increase liquidity.

The current supply-demand imbalance, characterized by an oversupply of capital relative to deal flow, has drastically altered the market landscape. Increased deal competition has led to spread compression, borrower-friendly terms, and a diminished illiquidity premium. These aren't necessarily bad loans but are often priced poorly, where the yield is insufficient for the assumed risk, also quoted by some market participants as "return-free" risk. Discounts on these loans are necessary to properly price this risk to compensate for what were potentially below-market coupon rates.

With Canada's current nascent secondary credit market, institutions capable of quickly identifying, underwriting, and transacting on these opportunities will benefit from funds that become forced sellers for non-fundamental reasons. This allows savvy investors to capitalize on mispriced risk and distressed sales, positioning themselves advantageously in the evolving market landscape.

Outlook & Conclusion

Like the post-Great Financial Crisis shift in the U.S., Canadian banks should focus more on syndicating risk to institutions rather than holding it on their balance sheets. This transition presents a significant opportunity for banks and buy-side institutions to collaborate in creating liquidity within an otherwise illiquid asset class. Moving forward, this should cultivate an investment landscape akin to the U.S. institutional term loan market, where institutions hold corporate debt, and banks provide liquidity through secondary trading desks.

Private credit in Canada is expected to follow the path of the U.S. high-yield bond market and institutional loan market, evolving from direct lending and club deals into syndicated, tradable loans with various forms of liquidity. This transformation will grant Canadian corporations access to crucial debt capital that has been absent for decades while also de-risking bank balance sheets by transferring risk to adept institutional investors. Funds best positioned to leverage these long-term trends will be those with strong fundamental underwriting standards and the ability to source term debt in the secondary market.

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Digital Asset Landscape in Canada: A New Dawn Amid Resilience and Innovation

By: Sebastien Davies
VP, Research at Aquanow

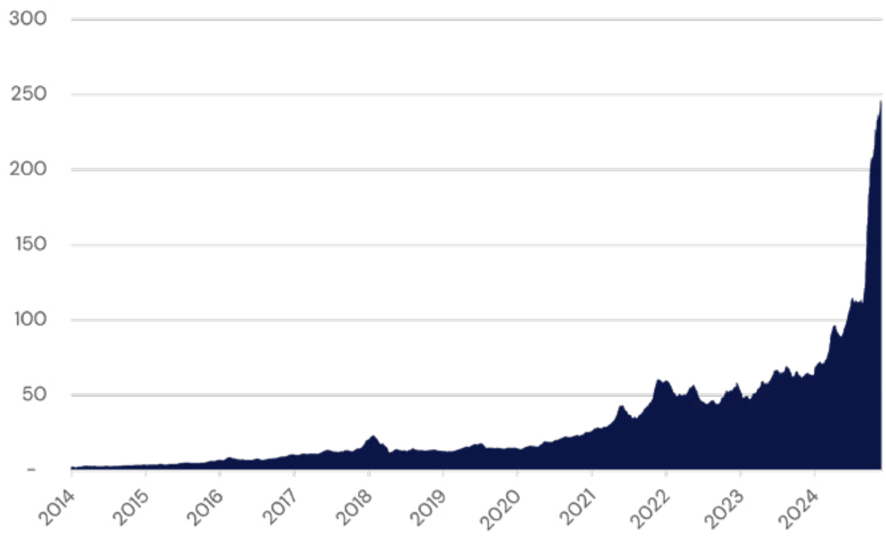
Digital Asset Landscape in Canada: A New Dawn Amid Resilience and Innovation

Canada's financial system has long been celebrated for its stability, security, and maturity, predominantly underpinned by its five major banks. However, beneath this conservative facade lies a burgeoning ecosystem of digital assets that is increasingly capturing the global spotlight. As digital assets evolve from speculative tools into a legitimate asset class, Canada finds itself at the intersection of innovation and regulation, poised to become a leader in this transformative space.

Resilience in the Face of Adversity

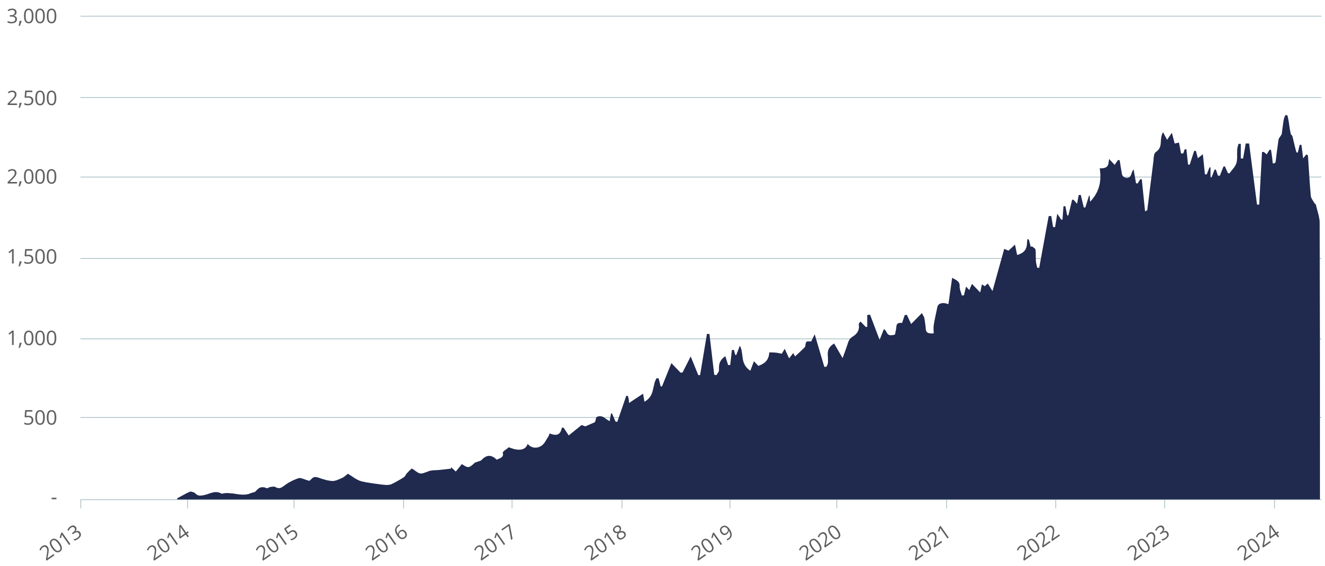
The global digital asset market has shown remarkable resilience, particularly in the aftermath of high-profile collapses of key industry figures. Where one might have anticipated a retreat, the opposite has occurred: digital asset markets have rebounded, and in many cases, have thrived. This resilience is evident not just in market performance but in the growing number of active users, who are pushing participation to new heights. This resurgence is a testament to the robustness of the digital asset ecosystem, which continues to innovate and expand despite the uncertainty that often surrounds it.

Total Monthly Active Users of Top 20 Crypto Projects (in millions)



Source: AQN Digital, TokenTerminal

Total Core Developers of Top 20 Crypto Projects



Source: AQN Digital, TokenTerminal

A Healthy Developer Ecosystem

Locally, one of the key drivers of this resilience is Canada's vibrant developer ecosystem. The country's major cities are home to blockchain startups, decentralized finance (DeFi) projects, and digital asset exchanges that are not merely following global trends but often setting them. While there has been a recent shift of developers toward emerging fields like AI, driven in part by regulatory uncertainty, Canada continues to foster blockchain innovation through its strong educational institutions, collaborative communities, and a history of pioneering open-source development.

Toronto, supported by ventures and research from nearby Waterloo, hosts over 400 blockchain startups, making it a global leader in concentration. Montreal's McGill and Concordia universities contribute to a thriving research landscape, while Vancouver, with the second-highest number of crypto-related businesses in Canada, has produced several industry-leading projects. Alberta is also making strides, with its government embracing novel Bitcoin mining solutions and other digital asset initiatives. Canadian developers remain central to the evolution of blockchain, driving advancements in smart contracts, cryptography, and beyond, even as they tackle a broader range of global technology challenges.

Navigating Regulatory Uncertainty

Canada has historically managed to strike a balance between fostering innovation and ensuring regulatory oversight, allowing crypto-related businesses to grow within a relatively stable framework. However, the recent direction taken with stablecoins suggests a shift that may not fully support the industry's continued growth. While the Canadian Securities Administrators (CSA) have played a critical role in shaping an innovative yet responsible operating environment, the approach toward stablecoins—particularly the classification of these assets as securities and derivatives—raises concerns about stifling growth. The challenge lies in ensuring that regulatory measures do not inadvertently hinder the very advancements they seek to govern.

Innovation at a Crossroads

Canada's regulatory bodies have long been seen as allies to innovation, carefully crafting frameworks that both protect investors and allow new technologies to thrive. However, the latest regulatory moves concerning stablecoins could disrupt this delicate balance. By imposing stringent securities regulations on stablecoins, there's a risk that these measures might stifle a vital segment of the digital asset market. Protecting investors should be paramount, but it's equally important to ensure that these regulations do not inadvertently hinder the competitive edge of Canadian businesses. A more tailored regulatory approach could help maintain Canada's position as a leader in digital innovation, while still safeguarding the interests of all stakeholders.

Collaborative Evolution and Future Outlook

One of the standout features of Canada's regulatory landscape is the collaborative approach taken by authorities. Regulators have actively engaged in dialogue with crypto businesses, striving to understand the technology and its implications. This willingness to collaborate has led to the development of practical and effective regulations, fostering a supportive environment for innovation. However, the pace of regulatory development can sometimes lag behind the needs of the rapidly growing industry.

A major hurdle for the industry, both in Canada and internationally, is limited access to banking services. Many crypto businesses struggle to secure banking relationships, which significantly stunts their market access and operational efficiency. In Canada, this challenge remains a critical bottleneck for the ecosystem, as traditional financial institutions remain cautious about engaging with digital asset companies.

Despite these challenges, Canada's measured regulatory approach has helped avoid some of the pitfalls seen in jurisdictions with more aggressive strategies. As the digital asset space continues to evolve, Canada's ability to adapt its regulations and address these banking barriers will be crucial to positioning the country as a leader in responsible crypto innovation and adoption. By continuing this collaborative evolution, Canada can set the stage for sustainable long-term growth in the industry.

Canada's Competitive Edge: Talent, Stability, and Innovation

Canada's position as a global leader in digital assets is bolstered by its ability to attract and retain top talent from around the world. Favorable immigration policies, coupled with political and economic stability, make Canada an attractive destination for entrepreneurs and innovators in the digital asset space. The country's educational institutions are also playing a crucial role, producing a steady stream of graduates with the skills needed to drive the industry forward.

Canada's competitive edge is further strengthened by its leadership in core technologies such as artificial intelligence (AI), machine learning, and blockchain. These technologies are not only powering innovations in digital assets but are also helping to create new applications that can be integrated into the broader financial system. Canadian companies are at the forefront of these developments, leveraging their expertise to create products and services that are not only innovative but also secure and scalable.

The Role of Advocacy and Education

The role of advocacy and education cannot be overstated in the development of AIMA's digital asset landscape. Organizations such as the Canadian Web3 Council and the Canadian Blockchain Consortium are actively working to educate the public, businesses, and regulators about the potential of digital assets. These organizations are also involved in policy discussions, ensuring that the voices of the industry are heard at the highest levels of government.

Education is equally important at the grassroots level. Canadian universities are increasingly offering courses and programs focused on blockchain and digital assets, preparing the next generation of leaders in this space. This educational push is essential for building a workforce that is knowledgeable and skilled in the complexities of digital assets, ensuring that Canada remains at the forefront of this rapidly evolving industry.

Looking Ahead: The Future of Digital Assets in Canada

As we look to the future, it's clear that Canada is well-positioned to be a global leader in the digital asset space. The country's stable financial infrastructure, combined with its innovative tech ecosystem, creates an environment where digital assets can thrive. While challenges remain—particularly in terms of regulatory clarity—the overall trajectory is positive.

The resilience and growth of the digital asset markets, even in the face of significant challenges, underscore the strength and future potential of this dynamic sector in Canada. As innovation continues and the regulatory environment becomes more defined, Canada is set to play a pivotal role in the global digital asset ecosystem.

In conclusion, Canada's digital asset landscape is a testament to the country's ability to adapt and innovate. With continued collaboration between fintech and traditional finance, positive regulatory engagement, and a commitment to education and advocacy, Canada is on track to establish itself as a hub for digital assets and blockchain technology. The future is bright for digital assets in Canada, and the country is poised to lead the way in this exciting new frontier.

Appendix: Resources on Crypto Regulations in Canada

Government Resources

- Financial Consumer Agency of Canada: Provides consumer information on crypto assets, risks, and protections.
- Canada Revenue Agency: Offers guidance on tax treatment of cryptocurrencies and other crypto assets.
- Canadian Securities Administrators: Provides investor tools and information on crypto asset regulation.

Regulatory Bodies

- Ontario Securities Commission (OSC): Maintains a list of registered crypto asset trading platforms.
- Financial Transactions and Reports Analysis Centre of Canada (FINTRAC): Oversees anti-money laundering regulations applicable to crypto businesses.

Industry Associations

- Alternative Investment Management Association - Canada: Engages with regulatory bodies in Canada and across the globe.
- Canadian Blockchain Consortium: Represents blockchain and cryptocurrency companies in Canada.
- Canadian Web3 Council: Advocating for an inclusive digital economy for all Canadians through Web3.

Legal Resources

- Canadian Bar Association: Offers resources and articles on cryptocurrency law.

Educational Resources

Canadian Securities Institute: Offers courses on blockchain and cryptocurrencies.

International Resources

Financial Action Task Force (FATF): Provides global standards for cryptocurrency regulations.

International Organization of Securities Commissions (IOSCO): Offers guidance on crypto-asset trading platforms.

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The Real Estate Market in Canada: An Overview of the Commercial Mortgage Debt Market

By: Aaron Goddard

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By: Adam Dean

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cmls

The Canadian commercial mortgage debt market is a vital segment within the broader alternative investment landscape. According to Intellifi Corporation, as of 2023, total outstanding balances (OSB) of commercial mortgage lenders reached approximately $449 billion, with origination levels of about $86.3 billion. These reported figures were non-inclusive of any funded or unauthorized portions of construction mortgage facilities across the Canadian market. This article provides an overview of the current market size, highlights key participants and how they approach the market, describes the profile of public and private investment managers' investments in commercial mortgage debt, and provides a comparison to corporate debt of a similar profile.

Participants in the Market

The commercial mortgage market is characterized by a diverse range of participants, each playing a significant role in the overall landscape:

Banks

Historically, banks have been the largest providers of financing in the commercial mortgage market. They play a crucial role in ensuring liquidity and stability through substantial capital contributions.

Investment Managers

This group has increasingly engaged in the commercial mortgage space, attracted by the potential for higher yields compared to traditional fixed-income investments. Investment managers often seek to diversify their portfolios by incorporating commercial mortgages, aligning with their strategies in alternative or private markets.

Credit Unions

These financial cooperatives have increasingly participated in the commercial mortgage space, providing competitive rates and local insights that can benefit borrowers.

Life Insurance Companies

Life insurance companies actively participate in the commercial mortgage market, leveraging their long-term investment horizon to finance stable, income-producing properties.

NHA Mortgage Backed Securities

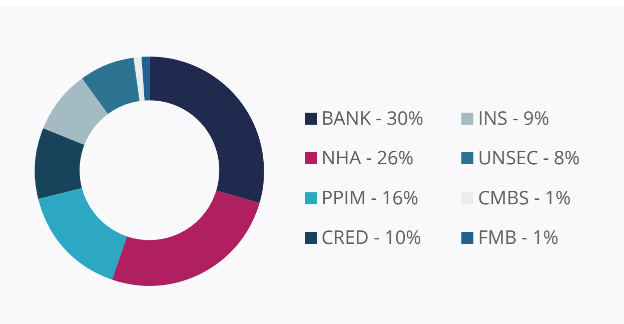
The Government of Canada, through the Canada Mortgage and Housing Corporation (CMHC), supports the multi-residential market with government sponsored securitization programs. These programs are funded with private capital but the underlying loans are insured by CMHC.

Other Participants

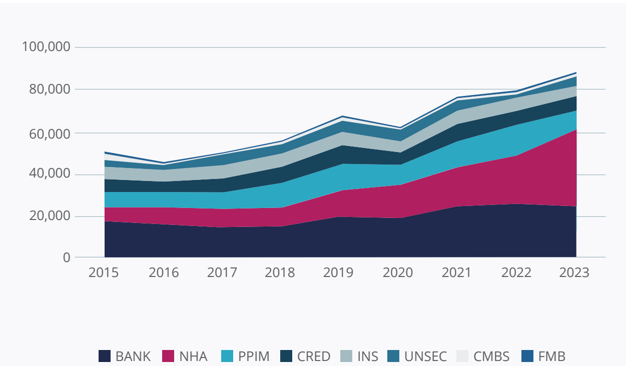
This category includes unsecured debt providers, Commercial Mortgage-Backed Securities (CMBS) issuers, and First Mortgage Bonds (FMB). On a combined basis, these vehicles provide a material contribution to the market, offering a variety of financing options and risk management strategies.

Market Size and Origination Levels

A pie chart below illustrates the percentage of market share by participant type within the Canadian commercial mortgage market as of 2023.



The following line graph shows historical origination volume trends by institution type, reflecting the evolution of financing in the commercial mortgage market over the years. Of note is a significant increase in the share in annual originations held by NHA Mortgage Backed Securities, largely resulting from our government's focus on supporting the multi-residential market to increase the level and quality of available rental market supply.



Investment Manager Strategies

A focused analysis of investment manager volumes reveals distinct strategies targeting certain risk profiles. Investment manager investment volumes can be categorized into two main segments:

High Yield

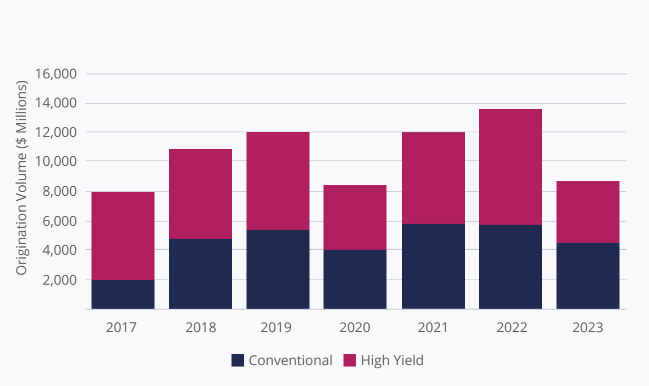
Typically associated with alternative or private market allocations, high-yield strategies aim to capture higher returns available in commercial mortgages. This includes second mortgages and mortgages on transitional properties – for example, a commercial property without existing leasing income. This segment attracted increased interest as investors sought yield in a low-interest-rate environment.

Conventional

Investments classified as conventional often serve as fixed-income replacements, aligning with broader investment goals for stability and lower volatility. This includes first mortgages on stabilized properties with rental income sufficient to cover the monthly mortgage payments.

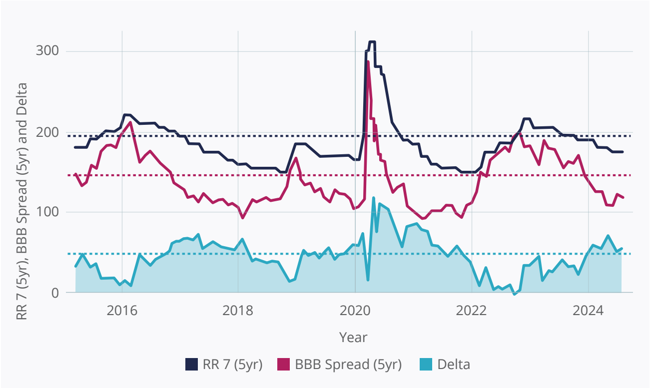
The chart below depicts the distribution of investment manager volumes among these segments. The increased overall trend of origination volume being generated by investment managers over time demonstrates their appetite for commercial mortgage market exposure. More recently, macro-economic shocks to the market (COVID in 2020 / Higher interest rates in 2023) have had material impacts to their annual origination output. We expect the historic positive trend to continue as the market stabilizes.

Annual Origination Volumes by Combined PPIM Category (2017-2023)



Yield Comparison and Excess Returns

When viewed as a fixed income replacement, yields generated by the Canadian commercial mortgage market have remained attractive, particularly when compared to equivalent risk corporate credit. Historically, commercial mortgages have provided excess returns in the form of illiquidity, complexity, and infrastructure (i.e. cost to originate) premiums associated with investing in commercial real estate debt. The chart below illustrates this yield comparison, demonstrating that commercial mortgage yields, as reported by Intellifi, consistently outperform BBB bonds and reinforcing their attractiveness for investors (average spread premium indicated below is 56 basis points).



Final Thoughts

In summary, the Canadian commercial mortgage debt market represents a large and vital component of the alternative investments ecosystem. Substantial growth in outstanding balances and origination levels has followed evolving strategies from the various participants, with significant growth in investment supporting the multi-residential rental market. Investment manager volumes have historically been increasing however has been hit by some macro-economic shocks in recent years. That being said their participation holds the potential for significant growth as awareness and acceptance of the product as an attractive fixed income replacement becomes more widespread. Managers who understand these dynamics are well-positioned to capitalize on emerging opportunities in the sector.

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Canadian Tax Considerations for Canadian Alternative Mutual Funds and other Investors in Liquid Alternative Products

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Amendments to Canada's "National Instrument 81-102: Investments Funds" in January 2019, has broadened the investment strategies available to Canadian investment funds and their retail investors. The changes have allowed for "alternative mutual funds" ("Alt Funds") to provide unique investment opportunities including exposure to liquid alternative products to retail investors. These strategies were typically only available in the hedge funds market and to limited investors. The change to the NI 81-102 rule was a welcome introduction for the industry which helps the ever-evolving Canadian investment management industry to stay competitive and meet investor needs for more investment choices and diversification. However, there are Canadian tax considerations for the Alt Funds and their investors with the introduction of more complex investment strategies with liquid alternative products including the use of derivatives, leveraging, and investing in foreign funds.

Derivatives

Derivatives are commonly used to speculate or hedge to offset market exposure to underlying assets. They also provide investors such as Alt Funds, in this case, with greater operational and market efficiency. From a tax perspective, with preferred Canadian tax rates on capital gains[1] determining whether the gains or losses from derivatives are on capital or income account can be quite complex. There is no statutory guidance on the income versus capital treatment of derivatives, rather the industry has relied on interpretations by the Canada Revenue Agency and limited case law to support their income or capital tax positions on derivatives. Generally, the analysis involved requires investors to consider the facts and circumstances including the characteristics of the transaction, the type of derivative used, the specific terms of the derivative and the investment manager's purpose and investment strategy for entering into the particular derivative contract.

For instance, if the Alt Fund's derivative hedges and is sufficiently linked to an investment held on capital account, treating the gains or losses arising from the transaction as capital would be supportable. However, where it is difficult to determine if the hedge is closely tied to the investment, any gains or losses on the derivative contract may be on income account.

Understanding the facts and circumstances of the derivative contract and any underlying transactions will help to determine an income or capital treatment for any gains or losses. However, each individual transaction and derivative should be separately analyzed to determine the appropriate tax treatment since the facts and circumstances may differ between derivatives and their strategies.

Leveraging

Alt Funds are permitted to leverage through methods including short selling, cash borrowing, and derivatives. While leveraging is a strategy often used by investors to increase returns on investments, there are significant tax implications that must be considered, including deductibility of any related expenses and also particularly due to the recent enactment of the Excessive Interest and Financing Expenses Limitation ("EIFEL") rules.

Generally, taxpayers can deduct expenses to the extent they were made or incurred to earn income from a business or property. Further, these expenses are generally deductible against any type of income provided the expenses are not capital in nature. As a result, it would be prudent to ensure that any interest and other expenses paid by an Alt Fund related to leveraging is deductible for tax purposes. In addition to the general expense deductibility, starting with taxation years that begin after September 30, 2023, investors need to consider the EIFEL rules. The EIFEL rules may impact an Alt Fund if it uses leverage, either directly or indirectly through other entities, and has interest and financing expenses. If applicable, the Alt Fund would be required to compute its interest and financing expenses and revenues to determine if the net amount exceeds 30% of its "adjusted taxable income," as determined under the EIFEL rules. The portion that exceeds this threshold would not be deductible for tax purposes. Certain types of derivatives and investments may be considered interest and financing expenses and revenues. In addition, certain investors including some Alt Funds may meet the exemption criteria under the EIFEL rules.

In addition to considering the deductibility of leveraging costs, careful consideration and planning are required to determine whether the Alt Fund is exempt from the EIFEL rules, and if not exempt, whether there is any impact to the fund's taxable income, as a result of the rules. It is prudent for fund managers to plan ahead to determine the implications, if any, of these complex rules.

Investing in Foreign Entities

One popular investment strategy when entering new mandates is to invest in foreign funds that have the investment strategy needed rather than for a fund to create and manage its own portfolio. However, there are various important implications to consider when an investor, including an Alt Fund invests in foreign funds. The considerations include foreign fund entity classification, which will determine how and when the fund will report income from the foreign fund, foreign taxes and other income matters.

Foreign fund entity classification

The Canadian tax implications of an investor investing in any particular foreign fund depends on the legal form of that fund. The legal form is important to determine the entity classification for Canadian tax purposes, which would then determine how the investor would report income from the foreign fund. There is no statutory guidance on how to characterize a foreign entity for Canadian tax purposes. The tax treatment of a foreign fund in its local jurisdiction has no bearing on how the fund would be treated for Canadian tax purposes.

The accepted approach that has been adopted by Canadian courts and supported by leading cases is a "two-step" approach. This approach first requires determining the characteristics of the foreign entity under foreign commercial law, and then comparing these characteristics with those of recognized categories of entities under Canadian commercial law, to classify the foreign entity under one of those categories. The categories for foreign funds in Canada include corporations, partnerships, trusts or co-ownerships.

For example, a Delaware limited liability corporation ("LLC") can be treated as a disregarded entity for U.S. tax purposes (i.e. a flow-through entity like a partnership), whereas the Canada Revenue Agency has concluded that an LLC is a corporation for Canadian tax purposes. This distinction in classification dictates the means and timing by which returns will be reported for tax purposes. For instance, consider the different tax considerations and the timing of income inclusion that would arise when receiving an annual allocation of income and loss from a partnership regardless of whether a distribution was paid versus a dividend from a corporation.

Once the foreign fund entity classification is determined, the Alt Fund will then need to determine whether there is sufficient information to report their income for Canadian tax purposes. The one common concern is an investment in a foreign fund structured as a partnership that has no statutory obligation to provide Canadian partners with any Canadian tax reporting. However, Canadian partners are required to pick up their allocable share of any income, gains, or losses of the foreign partnership computed in accordance with Canadian tax rules. Canadian partners are often left trying to determine what information from the foreign fund is available when they are required to compute their taxable income for their Canadian tax reporting.

Foreign taxes

With any foreign investment, foreign taxes should be considered. With respect to foreign funds, the foreign fund's entity type in its foreign jurisdiction and the type of income generated and/or distributions paid from the funds, will impact its Canadian investors.

The entitlement to a tax treaty and the applicable foreign tax rate will depend on the type of foreign fund. For instance, if a Canadian resident investor receives a dividend from a U.S. corporation, the dividend income would generally be subject to a 15% U.S. withholding tax rate under the Canada-U.S. Tax Convention ("U.S. Tax Treaty"). However, it is important to keep in mind that the withholding tax and applicable foreign tax credit would also be impacted by the type of foreign entity that holds the foreign security. For example, a Canadian investor holding shares of a Cayman corporation that in turn holds shares of a U.S. corporation is not able to benefit from the U.S. Tax Treaty. In this case, the Cayman corporation is the beneficial owner of the U.S. shares. Since there is no treaty between the United States and the Cayman Islands, the U.S. corporation would withhold taxes on the dividend paid to the Cayman corporation at the U.S. domestic tax rate of 30%.

Another potential issue that can arise is foreign tax leakage when a Canadian fund has investments in foreign funds. For example, when a Canadian fund invests into a foreign fund, the foreign fund may incur foreign withholding tax on its own portfolio (i.e. on the dividends received from its portfolio investments). However, when the foreign fund distributes the dividend to the Canadian fund, there may be an extra layer of foreign withholding tax that is to be applied to the dividend income. This results in a lower rate of return for the Canadian fund.

Other income matters

With any foreign fund investment, the Alt Fund should consider the application of the "offshore investment fund property" ("OIFP") rules. If applicable, the Alt Fund may be reporting income when it did not receive any distributions from the foreign fund, resulting in a 'dry tax.'

Where the Alt Fund's investment in a particular foreign fund is not an OIFP and may be more significant, the Alt Fund would need to consider whether the 'controlled foreign affiliate' and 'foreign accrual property income' rules apply. These rules are complex and fact specific. Assistance from a tax advisor is recommended to make this determination. If applicable, this would also require more onerous calculations of income from the foreign fund and additional Canadian tax reporting.

Certain types of foreign funds that are partnerships in their local jurisdiction may cause the partners of the partnership to file income tax returns in that foreign jurisdiction. For example, a foreign partnership that carries on a business in that foreign jurisdiction, may allocate its net business income to its partners in order for the partners, including the Alt Fund, to file a foreign tax return reporting its share of the foreign business income and to pay the relevant foreign taxes.

When investing in foreign funds, it is prudent to understand the structures and facts of the Alt Fund and the foreign fund. The foreign fund entity type for Canadian tax purposes and the structure will determine how, when and how much income the Alt Fund will report for Canadian tax purposes. To ensure the foreign fund investment is efficient and to mitigate any unknown tax issues, there are many matters to be considered including foreign tax reporting and leakage, and whether any of the imputed income rules apply.

Takeaway

While NI 81-102 has brought new opportunities for fund managers and retail investors, these new investment strategies with the use of liquid alternative products such as derivatives, leveraging, and foreign funds have added tax complexity. It is therefore important to keep in mind the opportunities and tax challenges that may be present with each type of investment. Planning ahead to understand the investment strategies and objectives of the Alt Fund as well as the types of derivatives, investments and activities the funds will undertake to carry out those strategies, can help to mitigate any resulting adverse Canadian or foreign tax consequences.

1 Currently, ½ of capital gains are included in a Canadian taxpayer's income. Proposed changes will increase the capital gains inclusion rate from ½ to 2/3 for the portion of capital gains realized after June 24, 2024, in excess of an annual threshold of $250,000 for Canadian resident individuals.

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Navigating Registration in Canada

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The Canadian marketplace offers securities industry participants a great opportunity for expansion or relocation. Canada's capital markets are some of the largest and most sophisticated in the world, with a diverse investor base and established regulatory framework. This article provides an overview of registration in Canada, as well as tips and tricks for navigating this process and avoiding delays.

Canadian Regulatory Landscape

Securities laws in Canada are not federally regulated. Each province and territory has a separate regulatory body responsible for administering the securities statute and regulating the securities industry in its jurisdiction. However, the Canadian Securities Administrators, an umbrella organization of Canada's provincial and territorial securities regulators, coordinates and harmonizes securities regulation across the country, including the registration requirements applicable to firms and the individuals acting on their behalf.

Firm Registration

Generally, unless an exemption is available, firms are required to register with the regulatory authority in each province and/or territory where they wish to carry out registerable activities. Specifically, registration is required if a firm is:

1. in the business of, or holding itself out as being in the business of, trading securities (a **Dealer**);
2. in the business of, or holding itself out as being in the business of, advising in respect of the buying and selling of securities (an **Adviser**);
3. acting as an underwriter; or
4. acting as an investment fund manager (an **IFM**).

Exemptions

There are several exemptions from the registration requirements. For example, the international dealer and international adviser exemptions allow certain foreign Dealers and Advisers to provide limited services without having to register in Canada, as long as the prescribed conditions are satisfied.

Under the international dealer exemption, conditions include that the foreign Dealer must be trading as a principal or agent only for the issuer of the securities, a "permitted client" (as defined in the regulations), or a non-Canadian resident. Activities are limited, for example, to those necessary to facilitate a distribution of securities primarily offered in a foreign jurisdiction or any trades with an investment dealer that is purchasing as principal.

Where the international adviser exemption is relied upon, foreign Advisers may advise permitted clients in relation to investments in foreign securities and in select instances, on Canadian securities, but only where the advice regarding Canadian securities is incidental to the advice on foreign securities. Furthermore, no more than 10% of the aggregate consolidated gross revenue of the foreign Adviser, its affiliates, and its affiliate partnerships can be derived from their activities in Canada.

Firm Registration Process

Where an exemption is not available, a firm will need to apply for registration with the applicable regulator(s). To ensure an expedient registration process, firms must be adequately prepared and supported. The following paragraphs summarize the primary steps and considerations in this process, with tips to avoid unnecessary delays.

Required Documentation

Registration requires the preparation of extensive documentation. In addition to the application form, registrants must submit a three year Business Plan (**BP**) and Policies and Procedures Manual (**PPM**). The BP must clearly describe the firm's business model. Before registering, it is important to think ahead through the firm's operations and finalize the BP, as changing directions later on can complicate and extend the registration process. The PPM must demonstrate the firm's ability to comply with the regulatory requirements applicable to its activities. Given the range of specified content, the PPM can be a lengthy document which takes a considerable amount of time to prepare. While some regulators require only the PPM's table of contents to be included in the application, others review the PPM in its entirety. Other required documents can include constating documents, extra-provincial registration (where applicable), organizational charts and audited financial statements or a statement of financial position (for newly established firms).

The registration application and all supporting documents should be submitted to the regulator as a single package. Incomplete or deficient applications will delay the approval process and some regulators may even return such applications. Further, it is critical that all information be true and accurate in all respects, as any false or misleading information in the application will undermine the applicant's credibility and fitness for registration, hinder the process, and constitutes an offence under securities legislation. Accuracy and thoroughness in preparing the application are essential to circumvent these concerns, streamline the process and avoid unnecessary costs and/or consequences.

Service Providers & Other Entities

A law firm and/or compliance consultant can assist with the preparation of the documents mentioned above. While this process is underway, the firm should simultaneously retain an auditor, an insurer and make the necessary arrangements to ensure that the firm is adequately capitalized and comfortably meets the applicable minimum working capital requirements. An auditor will be required to provide the audited financials mentioned above. The insurer can provide the firm with appropriate bonding or insurance coverage, as required by the regulations. Generally, the minimum capital requirements are $25,000 for Advisers, $50,000 for Dealers, and $100,000 for IFMs (in each case not including the deductible on the firm's financial insurance bond). The minimum working capital requirements are not cumulative, however.

Other entities to be aware of when seeking registration in Canada include the Canadian Investment Regulatory Organization (**CIRO**) and Ombudsman for Banking Services and Investments (**OBSI**). CIRO is a recognized Self Regulatory Organization (**SRO**), and firms seeking registration as an investment dealer and/or mutual fund dealer (two of the Dealer sub-categories) are required to become member firms of CIRO. OBSI is a national organization that helps resolve disputes between registered firms and their clients. Outside of Québec, all registered Dealers and Advisers, except for SRO members, are required to take reasonable steps to ensure that OBSI is accessible to clients with eligible complaints.

Individual Registration

Subject to limited exemptions, individuals who trade, underwrite or advise on behalf of a registered Dealer or Adviser, or act as the ultimate designated person (**UDP**) or chief compliance officer (**CCO**) of a registered firm must also be registered. Aside from the UDP and CCO, individuals acting on behalf of a registered IFM do not need to be registered.

In order for individuals to register, they must generally be sponsored by a firm that is registered or seeking registration. After filing the firm application with the appropriate regulator(s), the firm must complete and file a form for each individual that will be acting on its behalf.

It is critical to ensure early on that the individuals who will be acting on behalf of the firm satisfy the proficiency and integrity requirements, including the applicable education, training and experience requirements prescribed by securities legislation or the relevant SRO. The proficiency requirements are generally exam-based rather than course-based.

Timelines

Once a firm submits its registration application and supporting materials, the regulator will review the application and may reach out with questions, requests for further documentation, and/or conduct a pre-registration meeting with the principals of the firm. It is important to respond to the regulator in a timely manner and anticipate areas of concern, based on the previous operations and history of the firm or its principals. Experienced legal counsel can help identify such areas of focus.

Overall timelines will vary based on the applicant's registration jurisdiction(s) and categories, as well as the complexity of the application. This process generally takes between three to nine months to obtain registration. Timelines can be extended when dealing with novel industries such as cryptocurrencies for example, or if any issues are encountered during the course of the registration process.

Following registration, it is crucial that firms operate in accordance with the BP and PPM, and comply with applicable securities law requirements. The regulator will continue to monitor the firm's operations and conduct compliance reviews on a regular basis.

Canadian capital markets are robust and full of opportunities for financial services providers. The strength of these markets is underpinned by the well-regulated financial system and nation-wide commitment to transparency and investor protection. However, due to the complexities of Canadian securities laws, it is imperative that firms obtain legal advice before conducting any activities in relation to Canada.

The foregoing provides only a general overview, does not constitute legal advice and is provided for informational purposes only. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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In the alternative … The E, the S and the G of "ESG" are all in flux

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During 2024 there was a short period of time when this author asked herself what new ESG-related matters touching alternative investments might possibly be of interest for this article. As it turns out, this concern was in vain, because, while ESG-related issues are no longer new, there is no paucity of news and developments in this space of importance to AIMA members. Investors continue to demand additional transparency into their holdings and consistent data across portfolios, including those in alternative investments.

An article surveying the *entire* Canadian ESG landscape for alternative investments would be overly long, overly ambitious and, in all honesty, potentially quite tedious! As such, this bulletin instead focuses on three discrete developments touching on the E, the S and the G of "ESG":

1. the (ongoing) development of mandatory ESG-related reporting in Canada and the corollary impact on investor demand for ESG information;

2. musings on the early impacts on transparency and information available resulting from the anti-greenwashing provisions under the *Competition Act* (Canada); and

3. observations from the newly introduced "Modern Anti-Slavery" reporting requirements,

and ends with a brief discussion of the evolution of the Canadian Securities Administrators (**CSA**)'s approach to investment fund disclosure.

1. Ongoing development of mandatory ESG-related reporting in Canada

Canada is still in the nascent stages of mandatory ESG-related reporting. We are waiting to see where the CSA will land in terms of the scope and extent of: climate disclosure for listed issuers; corporate governance and diversity disclosure for listed issuers; and the adoption and/or adaptation of the International Sustainability Standards Board (**ISSB**) suitability disclosure standards on climate-related matters by the Canadian Suitability Standards Board (**CSSB**) and, eventually, incorporation of those standards into a rule by the CSA.

Climate-related disclosure obligations will be interesting to track, especially in light of the United States Securities and Exchange Commission's (**SEC**) voluntary stay of the implementation of its final rule for climate-related disclosure, pending completion of a judicial review. Of note, the SEC's climate disclosure rules only proposed disclosure of scope 1 and scope 2 greenhouse gas (**GHG**) emissions, subject to a materiality assessment, while the CSA's proposed rules contemplated the disclosure of each of scope 1, 2 and 3 GHG emissions. Whether the CSA will ultimately pursue scope 3 GHG emission disclosure in light of the developments south of the border remains to be seen.

Governance has rarely been such a contentious aspect of the "ESG" equation. However, since 2023 when the CSA issued bifurcated proposals where some commissions were in support of enhancing the disclosure of women in boards and senior management while others sought disclosure on diversity beyond gender, the topic has taken on increased profile and importance. At issue is not just the content of the required disclosure, but also the format that such disclosure should take – narrative or tabular. What investors actually want in terms of board disclosure and what is deemed to be "decision-useful" governance information remains to be adjudicated by the Canadian regulators.

While the content of all these disclosure obligations remains in flux, we can nonetheless project that the formalization of mandatory disclosures around ESG issues will only serve to amplify investor demand and expectations across the entire asset management industry, including in the alternative investment space. The more in-depth mandatory disclosures are required for certain issuers, the chances are that investors will seek similar information across all market participants.

2. Bill C-59 – tamping down on greenwashing, tamping down on information?

Another development to track is extent to which the introduction of specific anti-greenwashing provisions in Canada's *Competition Act* (through Bill C-59 – *The Fall Economic Statement Implementation Act, 2023* (**Bill C-59**)) will impact available disclosure and the behaviour of the asset management industry.

The Canadian government has launched a consultation on the guidance surrounding the implementation and interpretation of these new anti-greenwashing provisions – as well as the connected private right of action that can now be brought against advertisers. We can posit that this consultation was largely in response to certain Canadian issuers – particularly those in the oil & gas sector – removing their public-facing climate disclosure and statements. This was done as a result of those issuers perceiving the anti-greenwashing provisions to be too ambiguous and posing too great of a legal risk. This bold reaction made the headlines of publications like the New York Times, no doubt raising questions about whether Bill C-59 would have the unintended consequence of decreasing the amount of available climate-related ESG disclosure instead of increasing the quality and reliability of such disclosure.

For alternative managers, there is a general interest about what the impact of Bill C-59 will be on publicly available information as well as concerns about what climate-related claims they will feel comfortable making about the funds they manage.

In addition to requesting that the Competition Bureau defer to the CSA in matters related to misleading statements, including those pertaining to climate-related claims, industry groups have requested clarity on what constitutes an "internationally recognized methodology" upon which certain types of climate claims must be based.

3. Modern Slavery Reporting – a new frontier for investors and companies alike

Several alternative asset managers found themselves subject to Canada's recently enacted *Fighting Against Forced Labour and Child Labour in Supply Chains* Act (Canada) (the **Modern Anti-Slavery Act**) which is targeted at helping Canada meet its international commitments on the issues of forced and child slavery. These reports require disclosure of steps taken in the previous financial year to reduce the risk of forced and/or child labour in a reporting entity's supply chain.

Private equity and venture capital plan sponsors were somewhat surprised by the applicability of the Modern Anti-Slavery Act in cases where such sponsors either: control an entity that produces, sells, distributes or imports goods into Canada and/or or by virtue of the fund, general partner or fund manager selling, importing or distributing goods into Canada (such as office equipment).

Managers that were required to file Modern Anti-Slavery Reports observed the ways in which the Act was not tailored to capture these types of entities. We have observed a divergence of approaches taken by investors with respect to the level of detail in their respective Modern Anti-Slavery Reports. Though the policy rationale of increasing the public transparency of forced and child labour in supplies chains is clear, the Modern Anti-Slavery Act contains ambiguities we are hopeful will be addressed and clarified in a practical manner prior to the 2024 reporting season. Managers and sponsors who reported this year and/or who are unsure of whether they are subject to the reporting requirements should carefully consider their requirements and review the lessons learned during this first reporting cycle.

As with many ESG-related matters, the risks are not simply pecuniary or regulatory (there are fines of up to $250,000 for reporting entities and their officers and directors for failure to file a required report or for filing a report that is untrue). The public nature of these reports (which are required to be filed with the government of Canada and publicly on the reporting entity's website) will heighten transparency and, potentially, legal and reputational risk, for entities not otherwise accustomed to making public disclosure about such matters.

The CSA continues to react and respond with guidance

And so, since each component of E, S and G is in flux, it comes as no surprise that the CSA continues to evolve on ESG-related expectations. While we have yet to see regulations in respect of these issues, In March of 2024, we saw the publication of revised guidance in the form of CSA Staff Notice on ESG-related disclosure for investment funds (the **Revised ESG Notice**). Though the focus of this notice is primarily on public funds, it nonetheless contains important information about what the regulators view as acceptable and sufficient ESG-related investment fund disclosure and can be seen as best practice for investment funds offered under prospectus exemptions. The CSA's updated guidance and the *de facto* creation of four "internal facing" fund categories is impactful since categorization of a fund dictates what can – and what cannot - be said about an investment fund in its marketing materials and disclosure documents.

While the author was quickly able to resolve the question of what to write about, she remains in search of a definitive answer on how these fluid, sometimes divergent ESG currents will impact alternative managers in Canada into 2025. For now, she urges a careful eye on the disclosure expectations imposed on listed issuers to see where they drive investor expectations; an awareness of the impact of the prohibitions on greenwashing on the availability of certain climate-related information; and attention to the ways in which the CSA enforces and applies its Revised ESG Notice to investment funds in a second round of ESG-focused investment fund disclosure audits.

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Emerging Manager Advocacy

In 2021, AIMA released the whitepaper, "Building Support for Emerging Manager in Canada," by Claire Van Wyk-Allan. Following this, AIMA, CFA Societies Canada and the Emerging Manager Board have co-led an association working group, with support from PMAC and Innocap, on advocating for emerging asset manager entrepreneurs and further support for them. Highlights of the benefits of such emerging manager programs, potential policy solutions and roadmap to success are outlined below. To learn more about the group's advocacy efforts, contact Claire Van Wyk-Allan (AIMA), Michael Thom (CFA Societies Canada) or Charles Lemay (Emerging Manager Board).

Benefits of emerging manager programs

FOR MANAGERS

- Guidance and mentorship
- Operational efficiencies and shared services
- Capital allocation and commitments
- Institutional endorsement
- Cost savings
- Overall support allowing to focus on portfolio management

FOR ALLOCATORS

- Lower due diligence costs
- Greater transparency and enhanced governance/oversight
- Stronger relationships with manager
- Potentially lower fees and attractive terms
- Potential equity stake or revenue-sharing
- Attractive risk-return opportunities

FOR GOVERNMENTS AND REGULATORS

- Quality industry infrastructure with enhanced oversight
- Job creation
- Capital formation and economic development, helping to solve the entrepreneurship gap

FOR ALL

- Pride and prestige of fostering exceptional local talent, especially given global asset consolidation
- Ability to invest with specific impact goals
- Greater alignment of interests

Solutions for Better Support of Emerging Asset Manager Entrepreneurs in Canada

Category	Solution	Description	Cost
Direct Fund Investment	Capital Funding Pool	Pool of capital to be invested to select managers, to be re-distributed upon graduation (or if poor performance)	$$-$$$
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 and other trade organizations lead promotion of Canadian asset managers in international markets	$
Talent pipeline	Student Education, Awareness & Grants	Promote alternative investment education in high schools and universities, provide student grants for CAIA or CFA alts programs	$
Regulatory	Improve access for retail distribution	Increase independent product acces and reduce hurdles of internal risk ratings and allocation limits	$
	Minimize regulatory burden and improve registrant experience	Improved registration timelines and process, harmonized provincial system, codified exemptive relief for NI 81-102 alternative funds.	$
	Alignment with other leading jurisdictions	Pass-through expenses, less prohibitive proficiency requirements, confidential pre-registration	$
	Tax Credits/Refunds	Offer tax refunds for direct spending on these initiatives and for industry association dues	$

The Roadmap to Success

1
CREATING AWARENESS & SOCIALIZING THE CHALLENGES

LEADERS:
AIMA, CFA, EMB

KEY STAKEHOLDERS & TARGET AUDIENCE:
Regulators, Investors

2
REUNITING THE STAKEHOLDERS

LEADERS:
AIMA, CFA, EMB

LOCAL SPONSORS:
Local Market participants

3
DESIGNING THE MOST ADEQUATE SOLUTION WITH INITIAL INVESTOR COMMITMENT

LEADERS:
Innocap with a lead investor and consortium

LOCAL SPONSORS:
Local Market participants

SUPPORT FROM:
AIMA, CFA, EMB

4
STRUCTURING THE INVESTMENT AND THE PROGRAM

LEADERS:

Innocap, investor consortium, local market participants

5
DUE DILIGENCE AND SELECTING THE ASSET MANAGERS

LEADERS:

Innocap, local investment committee

6
PROGRAM MANAGEMENT, FUND RAISING, REPORTING AND ONGOING MONITORING

LEADERS:

Innocap, Program Director (to be hired locally)

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QEMP – The quest to grow financial centers by investing with emerging asset managers

By: Caroline Bergeron

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innocap

What is the Quebec Emerging Manager Program (QEMP)?

QEMP is the emerging manager program launched in Quebec in 2016 with the aim of supporting the local asset management industry by investing constructive capital in emerging asset management firms. The QEMP is structured as an investment fund that pools the assets of numerous institutional investors and currently invests with 13 of the most promising local emerging managers across public markets (equity and fixed income) and hedge fund strategies.

Where did the idea for this program come from?

Vital Proulx, CEO of Hexavest at the time, and Stephane Corriveau, CEO of AlphaFixe Capital, two successful Montreal based asset managers, had seen firsthand the benefits of emerging manager programs notably through Hexavest's own experience with similar programs in the US.

Many US states pension plans have established dedicated emerging and diverse manager programs investing billions of dollars in such firms. In collaboration with Finance Montreal, Quebec's financial cluster, Mr. Proulx and Mr. Corriveau brought 12 institutional investors together committing $250M for allocation to local asset management firms.

Innocap, the world leading managed account platform provider head quartered in Montreal, was appointed to design, structure and manage the QEMP. It has been driving the program since its inception.

Why is important to create programs such as QEMP?

New or emerging managers face multiple barriers when launching their firm including limited operational and compliance resources, the lack of an established track record and a low AUM. This makes it challenging to win mandates from institutional investors and can hamper growth.

Using a managed account platform, such as Innocap, provides additional comfort to institutional investors around control over the assets, enhanced transparency as well as engagement with the asset managers on an ongoing basis to help them in their growth trajectory.

Innocap provides the following services to QEMP:

- Investment, operational and ESG due diligence on asset managers at the inception of the mandate and continuous oversight,
- Engagement with asset managers around business development, market positioning and best practices,
- Fund legal and operational setup and ongoing fund management, and
- A strong governance framework including local institutional investors, allocators and established asset managers.

How has QEMP grown and supported emerging managers in Quebec?

With almost $600M in assets under management raised in 8 years, the QEMP is now well-known in the Quebec asset management industry. As a result, it continuously receives inquiries from emerging managers who are launching or growing their firm in the region who would benefit from structuring mandates through QEMP.

The program has drawn interest from other jurisdictions who are looking at replicating the Quebec model to create a vibrant ecosystem and retain the best talents locally.

QEMP is notably proud to collaborate with alternative managers such as Bastion, Evovest, Lionguard, Nordis, Plant-E and Converium who are building strong track records, increasing their AUM and who are now becoming leaders in their respective strategies. They are seeing growing interest from institutional investors and are establishing strong teams locally.

Over the last two years, QEMP has introduced structural changes that have generated positive impacts for its investors:

- Increase the size of its allocations to $50M per mandate.
- Negotiate revenue sharing agreements with some emerging managers to align interest of investors with asset managers.
- Clarify entry and exit criteria as well as emerging managers KPIs.
- Enhance emerging manager engagement by hiring Isabel Trepanier as Program Director, an industry expert with over 18 years' experience selecting external asset managers for a large institutional investor.
- Strengthen its governance framework by boosting its board of directors and clarifying mandates of its investment committees.

Why should Canada, other provinces or investors generally adopt a similar program?

Financial centers benefit from innovation and the creation and growth of new traditional and hedge fund managers to disturb the incumbents. Equally, entrepreneurs in the financial sector also benefit from local programs to help during the key first years of their journey and allow them to grow and contribute to the local economy.

Investing with local emerging managers is an interesting investment opportunity for all institutional investors for multiple reasons which could include attractive risk-adjusted returns offered by emerging managers, access to innovative strategies and the possibility to build strong relationships thanks to the proximity of managers.

Ultimately, establishing emerging manager programs is not only good for managers setting up, and for the economy, but crucially, it offers investor more choice and the potential for more growth. It's a win-win.

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Canadian Hedge Fund Categories, Directories, Indices and Performance

Hedge Fund Categories in Canada:

AIMA Canada was made a non-voting member of CIFSC in 2018. AIMA worked with the CIFSC to lead the development of categories that recognise the diversity of alternative investment products in the market and allow meaningful comparison of performance between investment fund strategies. The categories reflect the alternative investment strategies most widely used in Canada and currently include:

	Alternative Exempt Products	Alternative Mutual Funds and ETFs
Average Management Fee	1.35%	1.16%
Average Performance Fee	15.71%	15.38%
Average Short Term Trading Fee	2.97%	1.64%
Use of Performance Fee	54.33%	41.00%
Use of Hurdle Rate	34.07%	27.49%

As at October 31, 2024. Source: Fundata

Hedge Fund and Alternative Mutual Funds Directories

With the support of Fundata, AIMA Canada posts these hedge fund and alternative mutual fund directories on our website. Alternative IQ also hosts an annual Canadian hedge fund awards based on quantitative measure.

For additional reference, SEDAR is an official site that provides access to most public securities documents and information filed by issuers with the thirteen provincial and territorial securities regulatory authorities ("Canadian Securities Administrators" or "CSA") in the SEDAR filing system.

Hedge Fund and Alternative Mutual Funds Indices

The Scotiabank Canadian Hedge Fund Index (SCHF Index) offers both an equal weighting and an asset weighted calculation. The SCHF Index includes both open and closed funds with AUM greater than C$15 million and at least a 12-month track record of returns, managed by Canadian-domiciled hedge fund managers.

The Scotiabank Alternative Mutual Fund Index tracks the performance of the Canadian Alternative Mutual Fund universe. Returns are calculated monthly on an equal-weighted basis. Index constituents are limited to funds that are classified as Alternative Mutual Funds, as defined in National Instrument 81-102. Given the emerging nature of liquid alternatives, there is no minimum track record, or AUM, required for inclusion in the Index at this time.

Hedge Fund Performance

Canadian Hedge Watch publishes monthly performance for hedge funds in Canada. It also offers data from its own indices.

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Further Reading and Resources: Reference Links

1. Canadian Industry Data:

- Indices: Hedge Funds & Alternative Mutual Funds
- Fund Directories: Hedge Funds & Alternative Mutual Funds
- Fundata Infographic

2. AIMA Canada Educational Resources

- Investment Advisor 2-page DDQ
- AIMA/CAIA Risk Rating Guideline
- 5-minute Investor Education Videos
- Canada Hedge Fund Primer
- Launching Alternative Mutual Funds Handbook
- Recorded webinar with CE Credits
- Introduction to Alternative Investments and Benefits of Adding to your Portfolio
- Alternative Infographic
- Product Structure Comparison
- AIMA Canada Handbook 2019
- and more here

3. Regulators & Industry Leadership

- Ontario Securities Commission (OSC)
- L'autorite des marches financiers – Quebec (AMF)
- BC Securities Commission (BCSC)
- Alberta Securities Commission (ASC)
- Canadian Investment Regulatory Organization (CIRO)
- Investment Funds Institute of Canada (IFIC)
- Canadian Investment Funds Standards Committee (CIFSC)
- Sedar
- AIMA Canada Comment Letters
- AIMA Regulatory Horizon Scan

4. Local Association Partners & Events:

- Conseil des Gestionnaires en Émergence Quebec / Emerging Managers Board Ontario (CGE-EMB)
- CFA Societies Canada, Toronto, Montreal, Vancouver, Calgary, Victoria
- CAIA Chapters Canada West, Toronto, Montreal
- 100 Women in Finance Toronto (100WF)
- VersaFi/Women in Capital Markets (WCM)
- Introduction Capital Canadian Alternative Investment Forum (CAIF)
- Portfolio Management Association of Canada (PMAC)
- Canadian Venture Capital & Private Equity Association (CVCA)
- Private Capital Markets Association (PCMA)
- Alternative IQ Hedge Fund Awards (AiQ)
- ACG Toronto
- The Association of Asian American Investment Managers (AAAIM)
- With Intelligence
- Preqin
- Investment Diversity Exchange (TIDE)
- SuperReturn / Informa
- Association of Investment Management Sales Executives (AIMSE)
- FIAMtl

5. AIMA Global Research and Resource Highlights

- Navigating Private Placements
- The AIMA/CAIA Trustee series papers:
  - The Way Ahead
  - Portfolio Transformers
  - Made to Measure
  - Efficient Flows & Liquidity
- In Sync
- GenAI
- Financing the Economy
- Due Diligence Questionnaires
- Operational Sound Practice Guides

AIMA MEMBERSHIP

AIMA's Global Reach

Did you know that AIMA members are entitled to a host of benefits?

Committees and Working Groups

Working with peers to shape the industry and share expertise

Industry-Standard DDQs

Streamlines manager and sevice provider selection

Events and Networking Opportunities

Connect and network with peers at over 275 events held globally

Access to Experts

One-to-one contact with AIMA to discuss regulatory queries

Sound Practice Guides

Used to assist implementation of sound policies and processes in an increasingly complex operating environment

Government and Regulatory Affairs

Benefit from AIMA's advocacy work on a global scale

Research and investor Guides

Shaping the industry narrative to promote a better understanding of the alternative investment sector

Communications

Keep up-to-date on AIMA's recent activity, industry news and regulatory change

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A Sincere Thank You!

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