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Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
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Me Philippe Lebel, Corporate Secretary and Executive Director, Legal Affairs, Autorité des marchés financiers
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The Secretary, Ontario Securities Commission
20 Queen Street West 22nd Floor
Toronto, Ontario M5H 3S8

Dear Sirs/Mesdames:

RE: AIMA Open Feedback & Industry Comments

On behalf of AIMA Canada members, we appreciate the ongoing dialogue we have with you and look forward to continuing working with you on improving the overall health of the Canadian alternative investment funds sector.

Outside of any current consultations, we are summarizing our ongoing industry concerns and comments with regards to the regulation of hedge fund and private credit funds in Canada as they continue to arise within our membership.

In particular, we are highlighting the more complicated and burdensome regulatory landscape in Canada when compared to other major financial jurisdictions globally. We are concerned that these adversely impact the international competitiveness of Canadian alternative asset managers and the industry's growth in Canada, especially as global consolidation continues with many assets being managed by fewer, larger players outside of our borders.

We hope that these comments will help illuminate key issues faced by our membership nationally and possible solutions, with a particular focus on Ontario as it is the largest market for our membership.

About Alternative Investment Management Association (AIMA)

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

AIMA's global membership comprises approximately 2,100 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2.5 trillion in assets under management. AIMA Canada, established in 2003, has approximately 160 corporate members.

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

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $100 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member.

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

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

Comments

I. REGISTRATION AND FUND FORMATION

1. Registration Process

An ongoing area of concern are very significant costs and unacceptable delays associated with the registration process, particularly for new registrants. Frankly, registration in Canada takes too long and costs too much, especially compared to other jurisdictions.

We acknowledge that staff of the OSC's Compliance and Registrant Regulation Branch (**Staff**) has worked off the COVID-era backlog of registration applications. We also acknowledged that the service standard for registration has improved, but AIMA believes that registration takes too long and, partially as a result of this, is too expensive while unnecessarily increasing barriers to entry and therefore reducing the access Canadian investors have to a broader variety of managers.

The Canadian registration model lacks transparency. The rules seem best suited for the career progression of individuals employed by large financial institutions. The reality for many participants in the alternatives industry is very different and as a result, the experience component of the proficiency requirements is too subjective. This makes the application of rules unclear both for staff and prospective registrants and leads to a large number of time-consuming and expensive proficiency exemptions—increasing the burden for Staff and applicants.

The requirement OSC staff have recently been imposing that a prospective chief compliance officer (**CCO**) have compliance experience, along with, in relation to a prospective CCO of an investment fund manager (IFM), direct experience related to performing or overseeing IFM operations and fund administration, at a Canadian registrant is also daunting for startup managers and seems out of step with recent initiatives to support capital-raising for early-stage businesses. There is a real shortage of CCO candidates, which creates a very adverse feedback loop when the regulatory pre-requisite is having worked as a CCO. The CCO-for-hire model has not had any meaningful uptake and has not alleviated the shortage. It is also increasingly difficult to get one-person firms registered with the OSC, despite the fact that there is no requirement for a registered firm to have more than one registered individual (and it is common for firms to start with one registered individual when there is not yet a revenue stream, and hire additional staff after the firm's registration is granted).

Our members have observed that the Chief Compliance Officers Qualifying Exam (arguably the examination that should be the most relevant to a CCO's proficiency) is misaligned with the responsibilities of the CCO of a startup private fund manager (and arguably even of a more established one). The content of the required course is instead very aligned to the responsibilities of a CCO at a large bank or other market participant rather than a registered portfolio manager, IFM or EMD, leading to lost time and a poor allocation of scarce financial resources for new managers and new CCO candidates. The other exams are even less correlated to establishing the proficiency of a CCO in their specific role, calling into question their utility.

The members of the Canadian Securities Administrators (**CSA**) should be encouraging new registrants and CCOs. In our view, provincial securities regulators should both encourage increased competitiveness in the sector with enhanced processes for manager registration, while at the same time helping to foster an environment that attracts people to the role of the CCO at startup managers." Many new registrants are startups and Canadian small businesses too.

Many costs of registration are upfront costs and must be incurred when a prospective registrant has no revenue from registrable activities. These include hard costs (such as the fees of lawyers, auditors and consultants), opportunity costs and time. Costs associated with obtaining registration are a substantial barrier to entry for a new registrant firm and any delay in an application process by Staff results in an unfair administrative burden and can stifle competition. Delays impede business, capital formation, access to capital and efficient capital markets.

In Ontario, the OSC's current service standard for a new business submission is a commitment to make a decision on routine applications and notify an applicant within 120 working days (i.e., 6 months in total) of receiving a complete and adequate application in acceptable form (target is for 80% or more of all routine filings received). Not only must an application be (i) complete, (ii) adequate and (iii) in acceptable form, the OSC advises that the service standards for applicant firms and individuals are subject to the following additional conditions: (iv) all questions are answered with sufficient detail, (v) all regulatory obligations are met, (vi) there are no concerns with the applicant's fitness for registration, and (vii) the applicant responds to the OSC's request for information in a timely manner.

Each of these seven conditions is undefined, open-ended and subjective. The number of conditions and lack of clarity around them create many opportunities for miscommunication, misunderstanding and frustration on the part of the applicant firms and individuals when they are they are faced with requests for information from Staff that seem late in the process or are entirely unexpected.

To the extent a long registration process has been equated with a good process, we submit that the gatekeeper aspect of initial registration has gone too far. Staff must be afforded time to get it right and we all are aligned on the integrity of and confidence in the Canadian capital markets, but the other principles under the *Securities Act* (Ontario) must also be give due regard including:

- Balancing the importance to be given to each of the purposes of this Act may be required in specific cases.
- Effective and responsive securities regulation requires timely, open and efficient administration and enforcement of this Act by the Commission.
- Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized.

In addition to targeting shorter turn-around times, the current registration process could be ameliorated by regulatory staff hosting a pre-application meeting and interim meetings as required to discuss the applicant's business model and objectives, in line with a checklist of required items should be maintained and updated upfront and through the process. It would be crucial for these steps to not lengthen the process further, but to clarify questions earlier in advance of the new registrant interview that currently takes place near the end of the process.

While these comments focus on Ontario, our comments on the registration process, transparency and burden reduction, generally, apply equally in other CSA jurisdictions and we would encourage uniform standards to be adopted across the CSA where practicable.

2. Private Fund Manager Business Model

For investment managers that manage and market only proprietary prospectus-exempt funds to accredited investors and permitted clients on a limited basis, requiring registration in at least 3 different regulatory categories is unnecessarily burdensome. Registration and regulatory relief should be provided to managers who are not interacting with retail investors.

Furthermore, the narrow regulatory relief provided in several provisions of NI 31-103 that only applies in respect of each "permitted client that is not an individual" is arbitrary and without a clear regulatory rationale, and should be broadened to include all permitted clients. If the "permitted client" standard is intended to create a category of investment client that is either a) sophisticated enough in financial matters or b) wealthy enough to bear the risks associated with a more modest regulatory regime, then whether the investor is an individual or a legal entity should not matter. Registrants are not generally in a position to dictate the form of investing entity that a high net worth investor elects to use for an investment in a private fund. Yet an individual permitted client who invests directly is treated differently than an individual permitted client who invests via a personal holding company.

We would also encourage the CSA to codify the relief obtained by one market participant to add (a) a family trust category (similar to clause (w) added to the "accredited investor" definition in NI 45-106 Prospectus Exemptions in May 2015) and (b) a combined family financial assets category (taking into

account an individual together with a spouse and/or a family trust) to the definition of "permitted client" under NI 31-103.

3. The Passport System

The OSC's refusal to sign on to the national passport system has made the regulatory burden of non-Ontario headquartered managers significantly greater than it otherwise would be, effectively duplicating the same regulatory processes they already undergo in their provinces. Duplicating the same processes also effectively duplicates the time and cost associated with regulatory compliance in Canada. This unfairly prejudices managers that choose to be located outside Ontario while still hoping to access the large Ontario capital markets. To ease regulatory burden nationally, we encourage the OSC to sign onto the passport, which would be welcome step for global firms entering our markets as well.

4. NI 81-102 Exemptive Relief

The alternative mutual fund rules came into effect on January 3, 2019. We appreciate the many exemptions from the requirements of NI 81-102 that the CSA has granted. To reduce regulatory burden and cost to managers, we submit that it would make sense to codify routine relief issued over the past 5 years including: (a) short selling limit relief; (b) cash borrowing limited relief; (c) short sale collateral relief; and (d) multiple custodian relief.

II. FILINGS

1. Form 45-106F1 *Report of Exempt Distribution*

Schedule 1 to Form 45-106F1 is submitted on an outdated and technically inadequate spreadsheet that would benefit from elimination or significant revision. Manual tracking of individual dealer relationships and trailer fee payments on a province-by-province basis is a substantial regulatory burden with an unclear regulatory objective. It is also unclear what regulatory objective is achieved by providing the regulator with the identities and detailed contact information for every accredited investor that invests in an offering (alongside the specific sub-paragraph of the accredited investor definition that is relied upon in respect of that investor). Furthermore, our members advise that the required forms are frustrating to complete manually and simple isolated errors require recompleting the entire form.

Based on recent experience, we note the following limitations with Form 45-106F1 that make it difficult to interpret and complete. This wastes time and resources and the resulting data provided is not accurate.

Item 7 (Information About the Distribution), Part (d) (Types of securities distributed) of Form 45-106F1 is problematic for partnership securities for the following reasons:

- The Form does not distinguish between LP interests and LP units for limited partnerships
    - An LP interest is a single security and does not have a fixed or "single price"; the price is whatever the investor paid or agreed to contribute as a capital contribution to the fund
        - For example, Pension Plan Investor A may agree to make a capital contribution of $1 million to a Fund and Pension Plan Investor B may agree to make a capital contribution of $5 million to the same Fund

        - Capital Commitments are typically called or drawn down in tranches when required to fund the operations of the Fund including Fund costs, management fees and acquisition costs
    - The security code "LPU" means "Limited partnership units and limited partnership interests (*including capital commitments*)" - we note that these are three different concepts under the same code
- The Form does not distinguish between an LP capital commitment which is a binding commitment to invest a maximum amount during the investment period of the Fund that can be a number of years versus securities that are fully paid on closing
- The Form does not recognize that the price per security may not be determined until after the Form filing is due. For example, subscribers may be admitted on the first day of the month but the pricing net asset value per unit of the Fund (**NAV**) may not be available until the 15th day of the month. In this example, the Form must be filed 5 days before the NAV is available

In addition to clarifying the Form and reevaluating the data collected for relevance against the regulatory objectives behind its collection, we submit that all types of funds, especially those in a continuous or extended offering, should be permitted to file a revised Form either:

- On an annual basis, like investment funds may elect to do; or
- Monthly not later than 10 days following the end of the month in which a distribution of securities was made

These changes would significantly reduce the regulatory burden for alternative asset managers and improve the quality of the data collected.

III. DISTRIBUTION CHALLENGES

1. Internal Dealer Risk Ratings

Many dealers automatically rate private funds as "high risk" when this is not supported by the data for a specific fund or its index. The AIMA/CAIA Risk Rating Guideline was designed to be a reference for dealers based on the available data within indices (which we note, won't be without survival/selection bias etc. so not perfect either) and to support manager discussions with dealers on where their fund should in fact sit on the risk spectrum based on their historical volatility and performance, since this may of course differ from index.

Canada is essentially the only jurisdiction to employ this practice and while intended to benefit and protect the end investor, it often needlessly precludes diversifying or defensive strategies from the asset allocation mix or limits the amount that can be included, due to the additional limit on allocations to high risk-rated funds. Dealers take different approaches to internal ratings, with some using 3 levels (Low, Medium, High), some using 5 levels (adding low-med, and med-high), and even one using a numeric scale of 10. The result of this lack of uniformity is unfortunately, enhanced regulatory burden and market confusion.

Five years on from launching this risk rating guideline, alongside the launch of liquid alts in Canada under 81-102, some favorable outcomes have occurred. Some managers have seen their risk ratings reduced for prospectus-exempt funds, while most dealers are taking the risk rating as defined in prospectus for liquid alts, which is great. However, while this will never be a one-size-fits all approach, the majority of private funds are still rated automatically high risk, and thus more work still remains

to be done.

While neither CSA or CIRO don't feel there is a role for them to influence these ratings (a solely Canadian construct), these continue to present significant barriers to alternative fund implementation in portfolio construction and are totally unique compared to other global jurisdictions.

2. Client-Focused Reforms Impact

It is well known that certain product shelves shrank in response to the client-focused reforms (CFRs), thereby reducing competition and choice for investors. We encourage open platforms and stress the importance of access to third-party, independent products from both local and global firms.

One of the other unintended consequences of the CFRs is that even where products shelves remain accessible, the alternative fund industry bears the burden of the enhanced due diligence requirements. The response to CFR requirements has resulted in multiple diligence processes with an increased burden of responding to various due diligence templates that lack consistency in format across dealers and advisors. Despite overlap in content, the questions are worded differently and data is collected in different formats. Some platforms require reporting to specific data providers or else platform access is denied. To minimize the operational burden, we would encourage the use of virtual data rooms and due diligence providers, ideally with a consistent template (like the AIMA Due Diligence Questionnaire).

The CSA and other government entities are encouraged to consider the role they might play in facilitating solutions for greater access to capital with the goal of supporting emerging asset management entrepreneurs, creating jobs and fostering industry growth. Please see this detailed AIMA whitepaper, Building Support for Emerging Managers in Canada, to learn more.

IV. INTERNATIONAL COMPETITIVENESS

1. Research Expense Allocation

Globally, AIMA and prime broker surveys note anywhere from 50-90% of funds bear an allocation of research expenses as a fund expense, though CSA has been very rigid in opposing this, which impacts Canadian managers' international competitiveness with respect to fees generally. We would encourage the CSA to take a more flexible approach, based on comparative data from AIMA's Alignment of Interests research, AIMA's Expense Allocation Sound Practice Guide, AIMA's Paying for Research Guide and our 2015 comment letter, as well as other market research on this subject.

As we have discussed with the OSC, certain institutional investors prefer to see such research expenses unbundled from the management fee so it is transparent what they are paying for. In addition, one-time or periodic charges for research expenses may be a lower cost approach for investors than a permanent increase in management fees to cover such costs.

AIMA's In Sync research on alignment of interests between investors and managers further highlights the acceptance of pass-through expenses like paying for research, as well as the increasingly popular full pass-through model which would also include trader salaries, for example, all transparently disclosed to investors.

We would welcome the opportunity to discuss these concerns and potential solutions further. Please contact Claire Van Wyk-Allan, Managing Director, Head of Canada & Investor Engagement, Americas at AIMA with feedback and availability to discuss.

We look forward to working with you to ensure a productive, efficient and innovative capital markets ecosystem.

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION CANADA

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