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Dear Sirs/Mesdames:

RE: NI 81-102 PER OSC INVESTMENT FUND & STRUCTURED PRODUCT BRANCH REQUEST

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Further to the recent meeting on January 13, 2022 between AIMA and the OSC (Investment Fund & Structured Product & Compliance & Registrant Regulation branches), AIMA was asked to formally provide their perspective were the OSC to consider any alternative calculations of leverage risk under NI 81-102. AIMA is pleased to provide this response.

As published in 2019, NI 81-102 currently limits leverage to a maximum of 3x (excludes hedging via specified derivatives). Since this time, AIMA has noted select feedback from members with the constraints of such a method, and in particular how long/short fixed income funds or CTA funds, for example, may be too restricted in relation to other strategies with regards to this leverage definition to operate (properly) within the current guidelines.

In our 2016 comment letter to the CSA regarding NI 81-102, AIMA outlined a number of possible leverage measures from our *AIMA White Paper – Comparing Measures of Leverage in Funds*.

From a global perspective, AIMA would be supportive of NI 81-102 updates or exemptive relief that would align leverage calculations across jurisdictions so that investors globally to be able to best compare funds apples to apples, especially where liquid alternatives are concerned.

For example, the Value-at-Risk ("VaR") method is employed by other liquid alternative fund structures globally, namely alternative UCITS in the EU and UK and alternative mutual funds in the United States, which would set a fair precedent for the CSA employing this method as well.

The experience of the U.S. Securities and Exchange Commission (SEC) in deciding to adopt the VaR method is particularly relevant in this instance since the underlying leverage limit that is being addressed is similar to the requirement in NI 81-102. Specifically, Section 18(f)(1) of the U.S. Investment Company Act of 1940, as amended (the "40 Act"), prohibits an open-end fund from issuing or selling any "senior security" other than borrowing from a bank and subject to a requirement to maintain 300% "asset coverage". Since this requirement was adopted in 1940 the types of assets that needed to be addressed within the 300% asset coverage requirement has grown significantly in number and complexity, leading the SEC periodically re-evaluate how asset coverage should be interpreted, especially as relates to the use of derivatives.

In 2015, the SEC "determined to propose a new approach to funds' use of derivatives in order to address the investor protection purposes and concerns underlying section 18 of the [40 Act] and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives

transactions in light of the dramatic growth in the volume and complexity of the derivatives markets over the past two decades and the increased use of derivatives by certain funds."[1]

In the 2015 Release, the SEC put forward a new rule 18f-4 that would have permitted a fund to enter into derivatives transactions, as defined in the rule, provided that the fund:

1. complied with one of the following portfolio limitations such that, immediately after entering into any senior securities transaction:

    a. the aggregate exposure of the fund did not exceed 150% of the value of the fund's net assets; or

    b. the fund's full portfolio VaR was less than the fund's securities VaR and the aggregate exposure of the fund did not exceed 300% of the value of the fund's net assets; and

2. managed the risks associated with its derivatives transactions by maintaining qualifying coverage assets, identified on the books and records of the fund as specified in the rule and determined at least once each business day, with a value equal to at least the sum of the fund's aggregate mark-to-market coverage amounts and risk-based coverage amounts.

This rule proposal was an outgrowth of the SEC's approach up to then which relied on asset segregation as a means of addressing asset sufficiency, but also began to take some inspiration from the VaR approach that had been used by UCITS for many years.

There was significant pushback from the industry on this multi-pronged approach, with many commenters suggesting the proposed approach was operationally complex and asking for clarity.

Following much further consideration, the SEC reproposed rule 18f-4 in 2019, moving away from the historic approach of asset segregation and the proposed 2105 approach which included a focus on aggregate exposure and towards a model with a more refined VaR-based approach at its core to limit fund leverage risk, which was much more similar to the approach taken for UCITS.[2]

The version of rule 18f-4 set out in the Proposing Release would have allowed derivatives transactions not to be considered senior securities and therefore not counted toward the asset coverage limits in Section 18 of the 40 Act, among other things, the fund (i) complied daily with a relative VaR test (VaR of the fund's portfolio could not exceed 150% of the VaR of a designated reference index) or, if the derivatives risk manager was unable to identify a designated reference index that was appropriate for the fund taking into account the fund's investments, investment objectives and strategy, an absolute VaR test (VaR of the fund's portfolio could not exceed 15% of the value of the fund's net asset) and (ii) performed certain remediation and reporting if not in compliance. The VaR tests were proposed with a confidence level of 99% and a time horizon of 20 days.

Once again, the SEC received significant amounts of feedback, including from AIMA. AIMA, together with Managed Funds Association filed a response to the Proposing Release. That response requested that the Commission increase the VaR thresholds to 200% and 20%, respectively, with a 95%

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[1] SEC, Proposing Release, Use of Derivatives by Registered Investment Companies and Business Development Companies, 80 FR 80883, 80885 (December 28, 2015) ("2015 Release").

[2] SEC, Proposing Release, Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles, 85 FR 4446 (Jan. 24, 2020) ("Proposing Release").

confidence level that scales to 99% and a time horizon of 20 trading days, in line with the UCITS requirements.

In the end, the SEC adopted Rule 18f-4, which came into effect for new funds in February 2021 and which must be complied with by all registered investment companies and business development companies by August 2022.[3] The new rule, derivatives transactions will not be considered senior securities and need not be counted toward the asset coverage limits if:

1. The fund adopts a written derivatives risk management program reasonably designed to manage the fund's derivatives risks and to reasonably segregate the functions associated with the program from the portfolio management of the fund. The program must include:

    a. A risk identification and assessment;

    b. Risk guidelines;

    c. Stress testing;

    d. Backtesting;

    e. Internal reporting and escalation; and

    f. Periodic review;

2. The fund must comply daily with the relative VaR test (VaR of the fund's portfolio cannot exceed 200% of the VaR of a designated reference index) or, if the derivatives risk manager is unable to identify a designated reference index that is appropriate for the fund taking into account the fund's investments, investment objectives and strategy, the absolute VaR test (VaR of the fund's portfolio cannot exceed 20% of the value of the fund's net asset) and perform certain remediation and reporting if not in compliance. The VaR model requires a 99% confidence level and a time horizon of 20 trading days, but allows funds to choose to take into account additional observations for example by also measuring at a 95% confidence level and on shorter time horizons;

3. Funds meeting certain exceptions for limited derivatives users would not have to comply with 1 or 2 above;

4. The fund's board designates a derivatives risk manager;

5. The derivatives risk manager provides a written representation and report to the board on the derivatives risk management program on implementation and annually thereafter; and

6. Certain recordkeeping and retention requirements are met.

A full discussion of the requirements is contained in AIMA's implementation guide – "Derivatives Risk Management" – designed to aid investment advisers and funds seeking to come into compliance with the new rule. A copy of this guide has been provided with this letter for your reference.

With this SEC rule now in place, a significant proportion of the global assets under management in funds subject to a specific regulatory leverage limit are being assessed against a VaR measure. This includes US$407B under management in alternative UCITS and US$368B under management in U.S. alternative 40 Act funds, according to Preqin in January 2022. We believe that if the OSC were also to

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[3] SEC, Adopting Release, Use of Derivatives by Registered Investment Companies and Business Development Companies, 85 FR 83162 (Dec. 21, 2020).

adopt a VaR based approach to compliance with the leverage limitation in NI 81-102, it would be in good company.

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We appreciate the opportunity to provide the OSC with our views on this consultation. Please do not hesitate to contact the undersigned with any comments or questions that you might have. We would be pleased to meet with you to discuss our comments and concerns further.

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION (CANADA)

About the 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 (covering primarily hedge funds, private credit, liquid alternative funds and now also digital assets). 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 140 corporate members (53% managers, 18% institutional/retail investors, 29% service providers).

Under our pillars of Advocacy, Education and Communication, the objectives of AIMA are to provide an interactive and professional forum for our membership; act as a catalyst for the industry's future development; provide leadership in sound practices; enhance industry transparency and education; and liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management, though some are some of our country's largest traditional asset managers. 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 Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes prime services, custodial, accountancy and law firms with practices focused on the alternative investments sector.

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