AIMA Canada: Recommended MFDA Proficiency Standard for Approved Persons Selling Alternative Mutual Funds

RE: HARMONIZATION OF PROFICIENCY REQUIREMENTS FOR DISTRIBUTION OF ALTERNATIVE MUTUAL FUNDS

Executive Summary

AIMA Canada has long advocated for liquid alternatives to become broadly available in Canada. In 2019, the Canadian Securities Administrators (CSA) adopted significant amendments to NI 81-102 that introduced alternative mutual funds to the Canadian retail market. Currently, however, they are available only through IIROC advisors as a result of existing proficiency standards for dealers.

AIMA Canada is advocating for alternative mutual funds to be accessible by MFDA advisors. To ensure adequate proficiency among both MFDA approved persons and supervisors, AIMA Canada is recommending the phased in development of proficiency standards, as outlined below.

If adopted, MFDA member firms would have the option to choose from either acceptable independent course material that is already available in the marketplace - notably, the CAIA designation, CAIA Fundamentals certificate course and CSI Alternative Strategies: Hedge Funds and Liquid Alternatives course. Over time, MFDA members would also have the flexibility to produce a customized “in-house” course of specific topics that could also meet the proficiency standard.

A summary of the proposed phased development of proficiency requirements for MFDA dealers is below.

Table 1 - Phased Development of Proficiency for the MFDA dealers

<table>
<thead>
<tr>
<th>Approved Person</th>
<th>Current Proficiency Requirements For the MFDA(^1) to Distribute Alternative Mutual Funds</th>
<th>Proposed Interim Bridging Courses</th>
<th>MFDA Policy re Proficiency</th>
<th>Recommended Final State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved Person</td>
<td>One of the following: • CSC(^2) • DFC(^3) • CFA(^4) • Applicable proficiency standard mandated by a self-regulatory authority and approved/not disapproved by CSA</td>
<td>As an interim step, any one of the following courses would also be acceptable to meet alternative mutual fund product proficiency requirements: 1. CAIA(^5) designation 2. CAIA Fundamentals certificate course 3. CSI(^6) Alternative Strategies: Hedge Funds and Liquid Alternatives</td>
<td>MFDA issues a new policy prescribing the proficiency standard for Approved Persons of Members based on Schedule A &amp; B.</td>
<td>CSA approval of MFDA Policy following which Members may implement the new prescribed proficiency standards via: 1. An internal course managed by the Member based on the content in Schedule A &amp; B; or 2. An approved independent course provider(^7) such as: a. CAIA Association b. CSI c. IFSE d. CFA</td>
</tr>
<tr>
<td>Supervisor</td>
<td>DFC or CFA</td>
<td>Same as above</td>
<td>Same as above</td>
<td>Same as above</td>
</tr>
</tbody>
</table>

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1 MFDA = Mutual Fund Dealers Association  
2 CSC = Canadian Securities Institute  
3 DFC = Derivatives Fundamentals Course  
4 CFA = Chartered Financial Analyst Program  
5 CAIA = Chartered Alternative Investment Analyst  
6 CSI = Canadian Securities Institute  
7 We expect both the CSI and IFSE to integrate greater alternative investment material in their applicable courses to address these new proficiency requirements
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A. BACKGROUND

Alternative mutual funds became available to Canadian retail investors on January 3, 2019 as a result of amendments by the Canadian Securities Administrators (CSA) to National Instrument 81-102 – Mutual Funds (NI 81-102) and related National Instruments (Alternative Fund Amendments). Under NI-81-102, alternative mutual funds (commonly referred to as liquid alternatives) are offered to investors using the same offering documents (simplified prospectus, annual information form and fund facts document) as mutual funds. As of January 2020, there were over 90 alternative mutual funds offered under NI 81-102 with approximately $6B of assets under management.

Current IIROC Dealer Proficiency Requirements

Under the current regulatory regime, alternative mutual funds must generally be distributed through dealers that are members of the Investment Industry Regulatory Organization of Canada (IIROC). For such dealers, the proficiency requirements for conventional mutual funds and alternative mutual funds are generally addressed in subsection 3.4(1) of National Instrument 31-103 - Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103), which states that "[a]n individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently..." (the “General Proficiency Requirement”). IIROC dealers are also subject to the specific proficiency and education requirements of IIROC Rule 2900 (Rule 2900). Registered Representatives and Investment Representatives of IIROC dealers must meet the proficiency requirements specified in Section 4 of Rule 2900 and, under the General Proficiency Requirement, are expected to demonstrate an understanding of the attributes of alternative mutual funds (Know Your Product or KYP) in order to satisfy the dealer’s duty under section 13.3 of NI 31-103 to determine if an investment is suitable for a client (the suitability obligation).

Current MFDA\(^8\) Dealer Proficiency Requirements

In order to act as a dealer in connection with the securities of conventional mutual funds and labour sponsored investment funds or venture capital corporations, dealing representatives of mutual fund dealers (Approved Persons) are required to meet one of the following proficiency requirements under section 3.5 of NI 31-103:

(i) passing the Canadian Investment Funds Course Exam, the Canadian Securities Course Exam or the Investment Funds in Canada Course Exam;

(ii) satisfaction of the requirements in NI 31-102 to act as an advising representative of a portfolio manager;

(iii) earning the CFA Charter and having 12 months of relevant industry experience in the 36 months before applying for registration; or

(iv) the individual is exempt from registration as an advising representative of a portfolio manager as a result of Subsection 16.10(1) of NI 31-103 which grandfathers certain individuals who were registered as dealing or advising representatives on the date that NI 31-103 came into force.

\(^8\) MFDA = Mutual Fund Dealers Association of Canada
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Current Challenge

As a result of amendments to National Instrument 81-104 – Commodity Pools (now renamed Alternative Mutual Funds) (NI 81-104) made at the same time as the Alternative Fund Amendments, mutual fund dealers that are members of the MFDA are generally prohibited from distributing alternative mutual funds unless both the Approved Person and the individual designated by the mutual fund dealer to supervise the trades by such Approved Person (the Supervisor) meet the additional proficiency requirements of NI 81-104.

The proficiency requirements set out in NI 81-104 provide that each of the Approved Person and the Supervisor must have successfully completed one of a specified list of courses. NI 81-104 further provides an alternative proficiency if the Approved Person and the Supervisor meet the applicable proficiency standards mandated by a self-regulatory organization (SRO) if the securities regulatory authority or regulator has completed any required review, approval or non-disapproval of the regulatory instrument of the SRO that established those proficiency standards.

Please see the Table in Item C below for a review of current proficiency requirements for MFDA dealers regarding trades in securities of alternative mutual funds.

In reality, very few Approved Persons and their Supervisors meet the mandated proficiency requirements in NI 81-104 and the SRO (the MFDA) has not yet mandated any proficiency standards for the distribution of alternative mutual funds by MFDA member firms (Members). As a result, clients of Canadian mutual fund dealers have been generally unable to access the benefits of portfolio diversification, risk-reduction and non-correlated returns that are available via alternative mutual fund strategies.

B. RECOMMENDATION

We recommend that proficiency standards relating to the distribution of alternative mutual funds for Approved Persons and Supervisors be mandated by the MFDA and approved by the CSA.

We respectfully submit that the current proficiency requirements of NI 81-104 have very little relevance to enable Approved Persons and Supervisors of MFDA Dealers to demonstrate proficiency or an understanding of alternative mutual funds and the function they can serve within a client’s investment portfolio. We encourage the CSA to work with the MFDA on any proposed proficiency requirements relating to the distribution of alternative mutual funds that will provide a more viable alternative for MFDA dealers to sell these investment products for the ultimate benefit of the end client.

C. PROPOSAL

We propose that the MFDA adopt mandated proficiency requirements in a phased-in, three-step approach as follows:

1. Approve interim bridging courses that are sufficient to address proficiency requirements in the short-term pending development of a more complete policy prescribing proficiency;
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2. Develop a policy prescribing proficiency requirements for MFDA members to distribute alternative mutual funds, similar to MFDA Policy 8 and as set out in Schedules A and B hereto; and
3. CSA approval of the bridging courses and the MFDA’s prescribed proficiency standards.

The table below summarizes our suggested phased approach to proficiency requirements for MFDA dealers for distribution of alternative mutual funds.

Table 2 - Phased Development of Proficiency for the MFDA dealers

<table>
<thead>
<tr>
<th>Approved Person</th>
<th>Current Proficiency Requirements For the MFDA^9 to Distribute Alternative Mutual Funds</th>
<th>Proposed Interim Bridging Courses</th>
<th>MFDA Policy re Proficiency</th>
<th>Recommended Final State</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As an interim step, any one of the following courses would also be acceptable to meet alternative mutual fund product proficiency requirements:</td>
<td>MFDA issues a new policy prescribing the proficiency standard for Approved Persons of Members based on Schedule A &amp; B.</td>
<td>CSA approval of MFDA Policy following which Members may implement the new prescribed proficiency standards via:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- CSC^10 • DFC^11 • CFA^12 • Applicable proficiency standard mandated by a self-regulatory authority and approved/not disapproved by CSA</td>
<td></td>
<td>1. An internal course managed by the Member based on the content in Schedule A &amp; B; or</td>
<td>2. An approved independent course provider^15 such as:</td>
</tr>
<tr>
<td></td>
<td>1. CAIA^13 designation</td>
<td>2. CAIA Fundamentals certificate course</td>
<td>a. CAIA Association</td>
<td>b. CSI</td>
</tr>
<tr>
<td></td>
<td>3. CSI^14 Alternative Strategies: Hedge Funds and Liquid Alternatives</td>
<td></td>
<td>c. IFSE</td>
<td>d. CFA</td>
</tr>
<tr>
<td>Supervisor</td>
<td>DFC or CFA</td>
<td>Same as above</td>
<td>Same as above</td>
<td>Same as above</td>
</tr>
</tbody>
</table>

1. Interim Bridging Courses

Any of the following currently available courses would be acceptable today to meet alternative mutual fund proficiency requirements for Approved Persons:

1. CAIA (Chartered Alternative Investment Analyst) Association
   - CAIA Charter designation; or

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^9 MFDA = Mutual Fund Dealers Association  
^10 CSC = Canadian Securities Institute  
^11 DFC = Derivatives Fundamentals Course  
^12 CFA = Chartered Financial Analyst Program  
^13 CAIA = Chartered Alternative Investment Analyst  
^14 CSI = Canadian Securities Institute  
^15 We expect both the CSI and IFSE to integrate greater alternative investment material in their applicable courses to address these new proficiency requirements
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1. CAIA Fundamentals certificate course

or

2. CSI (Canadian Securities Institute)

   a. CSI Alternative Strategies: Hedge Funds and Liquid Alternatives

We submit that achieving a passing grade in any of the foregoing courses be approved as acceptable proficiency for Approved Persons and Supervisors of a Member in order to permit the Member to distribute alternative mutual funds.

Should CSI or IFSE Institute amend the CSC (Canadian Securities Course) and CIFC (Canadian Investment Funds Course), respectively, to include the content outlined in below Schedule A, either would also then be sufficient as suitable proficiency.

Supplemental industry reference resources include:

- AIMA/CAIA: The Way Ahead: Helping Trustees Navigate the Hedge Fund Sector
- AIMA/CAIA: Portfolio Transformers – Examining the role of Hedge funds as substitutes and diversifiers in investor portfolios
- AIMA/CAIA: Made to Measure - Understanding the use of leverage in alternative investment funds
- AIMA/CAIA: Efficient Flows - Understanding liquidity in alternative investment funds
- AIMA Canada: Investment Advisor Due Diligence Questionnaire Considerations
- CFA/CAIA: Alternative Investments: A Primer for Investment Professionals

2. Proposed Proficiency Policy

We propose that the proficiency requirements for Members mirror the approach outlined in MFDA Policy No. 8 – Proficiency Standard for Approved Persons selling Exchange Traded Fund (“ETFs”) (MFDA Policy No. 8). In light of recently approved rules by the CSA mandating continuing education for Members commencing in 2020, we believe that the harmonization of dealer proficiency requirements is further supported (common KYP and continuing education requirements across distribution channels).

This policy’s approach to proficiency, with the flexibility of using customized training programs established by Members or recognized third party program providers all while maintaining focus on material issues, is a transferable approach to proficiency for alternative mutual funds.

Using MFDA Policy No. 8 as a template, we would recommend that the MFDA issue a new policy (the Policy) prescribing the proficiency standard for Approved Persons and Supervisors of Members to distribute alternative mutual funds.

The Policy should include the following components:

- Alternative Mutual Fund Proficiency and Training: As a guiding principle, the Policy will state that it is the responsibility of the Member to ensure that each Approved Person advising on or
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transacting in alternative mutual funds and the Supervisor have adequate proficiency, education, and training;

- **Member Policies and Procedures:** The Policy will indicate that Members are responsible for performing a reasonable level of due diligence on alternative mutual funds prior to their approval for sale. As part of this due diligence, Members are required to determine if the alternative mutual fund meets the definition of an alternative mutual fund in NI 81-102. Where alternative mutual funds are sold by a Member, the Member must have appropriate policies and procedures regarding their sale. Approved Persons and Supervisor must receive specific training on those aspects of the Member's policies and procedures that deal with advising and transacting in alternative mutual funds. Such training must, at a minimum, include:

  o the differences between conventional mutual funds and alternative mutual funds under NI 81-102;
  o detailed product information in respect of the alternative mutual funds approved for sale by the Member; and
  o the disclosure information required for each transaction relating to alternative mutual funds;

- **Alternative Mutual Funds Product Training for Approved Persons:** The Policy will require that Approved Persons and Supervisors must receive alternative mutual fund product specific training. This requirement may be satisfied either by courses offered through independent course providers, or training offered through the Member. In either case, the courses or Member training must meet the minimum product training requirements set out below must also include an examination to be successfully completed by the Approved Person;

- **Minimum Alternative Mutual Fund Product Training for Approved Persons:** There are existing courses and examinations used by Approved Persons to satisfy proficiency requirements under NI 31-103 in respect of the sale of conventional mutual funds (such as the CSC) that provide training which overlaps with the information that Approved Persons and Supervisors would be required to know and understand for the purpose of providing advice and transacting in alternative mutual funds. Training must focus on unique aspects of alternative mutual funds that Approved Persons and Supervisors must understand in respect of the particular alternative mutual fund products offered through the Member. In addition, Approved Person and Supervisor training in this area must highlight key differences between alternative mutual funds and conventional mutual funds. **Schedules “A”, “B” and “C”** set out how new information and existing topics/concepts may be addressed as part of alternative mutual fund product training for Approved Persons.

The minimum requirements that must be addressed as part of alternative mutual fund product specific training for Approved Persons and Supervisors will be used to assess the adequacy of any alternative mutual fund product training provided by Members, or independent alternative mutual fund training courses offered.

MFDA Members must ensure that each Approved Person advising or transacting in alternative mutual funds and Supervisor has adequate proficiency, education, and training. In order to satisfy requirements under Rule 1.2.3, Approved Persons and Supervisors must receive appropriate training from the Member in respect of the following information about:
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(i) the key differences between conventional mutual funds and alternative mutual funds under NI 81-102;

(ii) the characteristics, features, benefits, and risks of alternative mutual funds; and

(iii) performance fees and how they are calculated for alternative mutual funds.

Alternative mutual fund product training for Approved Persons and Supervisors may be satisfied by courses offered through independent course providers noted in the proposal above, or training offered through the Member.

3. Delivery of Courses That Meet MFDA Policy

Our recommended final state is for CSA approval of the Policy and for each Member seeking to distribute alternative mutual funds to implement the Policy.

These new standards may be addressed via an in internal course managed by each Member based on the content in Schedules A & B or by an applicable approved independent course provider, such as the CAIA Association, CSI, CFA or IFSE.

Courses Provided by Member

Where alternative mutual fund product training for Approved Persons and Supervisors is provided by the Member, the training must include an examination to be successfully completed by each Approved Person and Supervisor. The Member must keep appropriate records of such training, as required under MFDA Rule No. 5 (Books, Records and Reporting). Examples include, but are not limited to, the following:

- attendance records;
- evidence of training sessions;
- content of training materials; and
- results of formal examinations.

Courses by Independent Course Provider(s) Where Alternative Mutual Fund product training for Approved Persons and Supervisors is provided by an independent course provider, course providers should be approved course providers, such as the CAIA Association, CSI, or IFSE.
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SCHEDULE A - TOPICS TO BE ADDRESSED AS PART OF ALTERNATIVE MUTUAL FUND PRODUCT TRAINING

The following is a potential syllabus that sets out how new information and existing topics/concepts could be addressed as part of alternative mutual fund product training for Approved Persons and Supervisors.

The information and charts in Schedules B and C set out how new information and the relevant topic/concepts may be addressed as part of alternative mutual fund training for Approved Persons and Supervisors.

INTRODUCTION TO ALTERNATIVE MUTUAL FUNDS

A. Background of the modernization of NI 81-102
   a. Description of the background leading to the amendments to NI 81-102 on January 3, 2019 and related National Instruments.

B. What is an alternative mutual fund and product comparisons
   a. Examination of the definition of alternative mutual fund in NI 81-102
   b. Comparing conventional mutual funds to alternative mutual funds
   c. Comparing alternative mutual funds to privately offered investment funds (hedge funds)
   d. Types of alternative strategies available in alternative mutual funds:
      i. Equity long/short
      ii. Global macro
      iii. Relative Value Arbitrage
      iv. Long/short credit
      v. CTA/Managed Futures
      vi. Market neutral equity
      vii. Merger arbitrage
      viii. Convertible arbitrage
      ix. Distressed debt
      x. Multi-strategy
      xi. Equity long-only
      xii. Emerging Markets
      xiii. Event driven

C. Description of specific parameters and investment restrictions of alternative mutual funds:
   a. Concentration Limit
   b. Short Selling Limit
   c. Single Issuer Short Sale Limit
   d. Combined Shorting and Cash Borrowing Limit
   e. Use of Specified Derivatives
   f. Maximum Leverage and Leverage Calculation Formula
   g. Performance Fees
   h. Custodial Arrangements
D. Features and Potential Benefits of alternative mutual funds:
   a. Diversification
   b. Risk reduction/downside protection
   c. Low to non-correlated returns / risk-adjusted returns
   d. Volatility reduction
   e. Return enhancement
   f. Protection from rising interest rates & inflation

E. Descriptions of general risks & due diligence recommendations
   a. Operational risks
   b. Investment risks
   c. Market risks
   d. Manager/Style risk
   e. Recommended manager & strategy due diligence

F. Operating costs of alternative mutual funds:
   a. Management fees
   b. Performance fees
      i. High water mark
      ii. Hurdle
   c. Trading Expenses
   d. Operating Expenses
   e. Trailing commissions

INVESTING IN ALTERNATIVE MUTUAL FUNDS
A. Description of CIFSC Alternative Fund Categories
   a. Alternative Equity Focused
   b. Alternative Credit Focused
   c. Alternative Market Neutral
   d. Alternative Multi-Strategy
   e. Alternative Other

B. Portfolio Management Considerations:
   a. Efficient Frontier
   b. Risk Budgeting
   c. Alpha and Beta
   d. Asset-Liability Matching
   e. Substitutes vs Diversifiers
   f. Benchmarking & applicable indices

C. Review existing obligations for KYC, KYP, Suitability Obligation

REGULATION OF ALTERNATIVE MUTUAL FUNDS IN CANADA
A. Description of alternative mutual fund offering documents
   a. NI 41-101 – General Prospectus Requirements
   b. Risk Ratings
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B. Description of Disclosure Requirements

C. Independent Review Committee
SCHEDULE B - MODERNIZATION OF NI 81-102 AND COMPARISONS

AN OVERVIEW OF THE CHANGE DUE TO MODERNIZATION

The amendments to NI 81-102 consolidated mutual funds, closed-end funds, commodity pools, and ETFs under one rule. The new regime will now include three sub-categories of funds within NI 81-102:

1. Conventional Mutual Funds
2. Alternative Mutual Funds
3. Closed-end Funds

The differences among alternative mutual funds, closed-end funds and conventional mutual funds are summarized in Schedule C.

KEY DIFFERENCES BETWEEN ALTERNATIVE MUTUAL FUNDS AND PRIVATELY OFFERED HEDGE FUNDS – AT A GLANCE

Even though alternative mutual funds provide investment flexibility when compared to conventional mutual funds, they are relatively limited compared to the diverse investment strategies that may be utilized by privately offered investment funds (hedge funds).

In addition, the Canadian securities regulatory regime imposes obligations on alternative mutual funds that are significantly different from the terms typically offered by hedge funds.

The key restrictions and reporting obligations applicable to alternative mutual funds relative to hedge funds are set out in the following table:

<table>
<thead>
<tr>
<th></th>
<th>ALTERNATIVE MUTUAL FUNDS</th>
<th>HEDGE FUNDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Investors</td>
<td>Alternative Mutual Funds: Available to the retail investors.</td>
<td>Hedge Funds: May only be distributed on a “private placement” basis in reliance on a prospectus exemption and are typically sold to high net worth investors that qualify as “accredited investors”.</td>
</tr>
<tr>
<td>Key Documents/Ongoing Disclosure</td>
<td>Alternative Mutual Funds: Publicly filed simplified prospectus, annual information form, fund facts document, audited annual and interim financial statements and management reports of fund performance. Mandated leverage disclosure in annual and interim financial reports. Top 25 portfolio holdings disclosed quarterly.</td>
<td>Hedge Funds: Investors typically receive an offering memorandum and audited annual and interim financial statements (which are not publicly filed). No mandated leverage disclosure or disclosure of top portfolio holdings.</td>
</tr>
<tr>
<td>Requirement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Governance</td>
<td>Alternative Mutual Funds: Independent Review Committee requirement.</td>
<td>Hedge Funds: No specific governance requirements.</td>
</tr>
<tr>
<td>NAV Calculation</td>
<td>Alternative Mutual Funds: Daily.</td>
<td>Hedge Funds: Daily, Weekly, Monthly (most common) or Quarterly depending on frequency of subscriptions and redemptions.</td>
</tr>
<tr>
<td>Redemption Rights</td>
<td>Alternative Mutual Funds: Daily (most common) or weekly as specified in Prospectus.</td>
<td>Hedge Funds: Weekly, monthly (most common) or quarterly. Monthly redemptions typically require a minimum of 30 days advance notice prior to the applicable redemption date.</td>
</tr>
<tr>
<td>Initial Holding Period</td>
<td>Alternative Mutual Funds: None, although managers may utilize Short Term Trading Fees as a disincentive and new alternative mutual funds have</td>
<td>Hedge Funds: May be none, 4 months, six months, a year or longer.</td>
</tr>
</tbody>
</table>

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<th>HEDGE FUNDS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Redemption</strong></td>
<td>the ability to have an initial freeze on redemptions for the first 6 months from date that the fund is first offered, all as specified in the prospectus.</td>
<td></td>
</tr>
<tr>
<td><strong>Proceeds</strong></td>
<td>Alternative Mutual Funds: T+2.</td>
<td>Hedge Funds: T+2.</td>
</tr>
<tr>
<td><strong>Risk/Compliance</strong></td>
<td>Alternative Mutual Funds: Daily monitoring of portfolio vs permitted limits in NI 81-102 and any other investment restrictions described in the prospectus.</td>
<td>Hedge Funds: Regular monitoring of portfolio vs investment restrictions generally imposed under applicable securities laws.</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td>Alternative Mutual Funds: Permitted, subject to the requirement that a performance fee may only be paid based on performance which has occurred since the time that a performance fee was last paid.</td>
<td>Hedge Funds: Permitted (no limitations).</td>
</tr>
<tr>
<td><strong>Performance/Incentive Fees</strong></td>
<td>Alternative Mutual Funds: Limited to 50% of NAV.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Borrowing (cash and / or securities)</strong></td>
<td>Alternative Mutual Funds: Limited to 50% of NAV, no cash cover required.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Short-Selling</strong></td>
<td>Alternative Mutual Funds: Limited to 50% of NAV, no cash cover required.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Leverage</strong></td>
<td>Alternative Mutual Funds: Maximum of 3X (excludes hedging via specified derivatives).</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Concentration Limit – issuer level</strong></td>
<td>Alternative Mutual Funds: 20% of NAV, subject to carve-outs (does not apply to short sale of government securities).</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Illiquid Assets</strong></td>
<td>Alternative Mutual Funds: 10% of NAV at initial investment; 15% hard-cap.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Restrictions on Investment</strong></td>
<td>Alternative Mutual Funds: No investment in: Real Property; Mortgages, other than guaranteed mortgages; or Loan syndications / participations if any responsibility to administering loan.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td><strong>Risk ratings</strong></td>
<td>Alternative Mutual Funds: As per NI 81-102, all Funds must have a risk rating as per the CSA's methodology.</td>
<td>Hedge Funds: No risk rating requirement.</td>
</tr>
<tr>
<td><strong>Fund of Fund investments</strong></td>
<td>Alternative Mutual Funds: May invest up to 100% of NAV in underlying alternative mutual funds, non-redeemable investment funds, conventional mutual funds and ETFs funds. Underlying funds must be NI 81-102 Funds and a reporting issuer in at least one Canadian jurisdiction. Investing in private pooled funds prohibited.</td>
<td>Hedge Funds: No limit.</td>
</tr>
<tr>
<td>Category</td>
<td>Alternative Mutual Funds</td>
<td>Closed-end Funds</td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Definition:</td>
<td>&quot;alternative mutual fund&quot; - a mutual fund, other than a precious metals fund, that has adopted fundamental investment objectives that permit it to invest in physical commodities or specified derivatives, to borrow cash or engage in short selling in a manner not permitted under NI 81-102. Investment funds that were formerly referred to as “Commodity Pools” are now alternative mutual funds under NI 81-102.</td>
<td>N/A</td>
</tr>
<tr>
<td>Concentration Limit:</td>
<td>20% of NAV</td>
<td>20% of NAV</td>
</tr>
<tr>
<td>Investments in Physical Commodities:</td>
<td>May invest in precious metal certificates, permitted precious metals, physical commodities or specified derivatives of which the underlying interests are physical commodities</td>
<td>May invest in precious metal certificates, permitted precious metals, physical commodities or specified derivatives of which the underlying interests are physical commodities</td>
</tr>
<tr>
<td>Illiquid Assets:</td>
<td>10% of NAV with hard cap of 15% of NAV</td>
<td>20% of NAV with hard cap of 25% of NAV</td>
</tr>
<tr>
<td>Short Selling Limit:</td>
<td>50% of NAV</td>
<td>50% of NAV</td>
</tr>
<tr>
<td>Single Issuer Short Sale Limit:</td>
<td>market value of 10% of NAV excluding shorting of “government securities”</td>
<td>market value of 10% of NAV excluding shorting of “government securities”</td>
</tr>
<tr>
<td>Limit on portfolio assets pledged as security with a borrowing agent (other than the custodian or a sub-custodian) in connection with Short Sale Transactions:</td>
<td>25% of NAV</td>
<td>25% of NAV</td>
</tr>
<tr>
<td>Cash Borrowing Limit:</td>
<td>Up to 50% of NAV</td>
<td>Up to 50% of NAV</td>
</tr>
<tr>
<td>Combined Shorting and Cash Borrowing Limit:</td>
<td>50% of NAV</td>
<td>50% of NAV</td>
</tr>
<tr>
<td>Use of Specified Derivatives:</td>
<td>May be used for investment purposes (including hedging) and/or to create synthetic leverage</td>
<td>May be used for investment purposes (including hedging) and/or to create synthetic leverage</td>
</tr>
</tbody>
</table>
## AIMA Canada: Recommended MFDA Proficiency Standard for Approved Persons Selling Alternative Mutual Funds

<table>
<thead>
<tr>
<th>Category</th>
<th>Alternative Mutual Funds</th>
<th>Closed-end Funds</th>
<th>Conventional Mutual Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Derivative Counterparty Rating and Exposure Limits:</strong></td>
<td>Can deal in specified derivatives (OTC) or with counterparties that do not have a designated rating.</td>
<td>Can deal in specified derivatives (OTC) or with counterparties that do not have a designated rating.</td>
<td>Must deal in specified derivatives and/or counterparties that have a designated rating.</td>
</tr>
<tr>
<td></td>
<td>Mark to market value of exposure under specified derivatives positions (other than cleared specified derivatives) with a counterparty that does not have a designated rating must not exceed 10% of NAV for a period of 30 days or more</td>
<td>Mark to market value of exposure under specified derivatives positions (other than cleared specified derivatives) with a counterparty that does not have a designated rating must not exceed 10% of NAV for a period of 30 days or more</td>
<td>Mark to market value of exposure under specified derivatives positions with any one counterparty must not exceed 10% of NAV for a period of 30 days or more unless: (i) the specified derivative is a cleared specified derivative, or (ii) the counterparty/guarantor of counterparty’s obligations has a designated rating.</td>
</tr>
<tr>
<td><strong>Fund of Fund Investments:</strong></td>
<td>May invest up to 100% of NAV in conventional mutual funds, other alternative funds or non-redeemable investment funds that are subject to NI 81-102</td>
<td>May invest up to 100% of NAV in conventional mutual funds, other non-redeemable investment funds or alternative mutual funds that are subject to NI 81-102</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>May invest up to 100% of NAV in another conventional mutual fund that is subject to NI 81-102</td>
</tr>
<tr>
<td><strong>Leverage and Leverage Calculation Formula:</strong></td>
<td>300%, calculated as aggregate value of indebtedness under borrowing agreements + aggregate market value of short positions + aggregate notional value of all specified derivative positions minus specified derivatives used for hedging purposes</td>
<td>300%, calculated as aggregate value of indebtedness under borrowing agreements + aggregate market value of short positions + aggregate notional value of all specified derivative positions minus specified derivatives used for hedging purposes</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Incentive Fees:</strong></td>
<td>Permitted provided that the basis of calculation must be described in simplified prospectus and incentive fee must be subject to a permanent “high water mark”</td>
<td>Permitted provided that the basis of calculation must be described in prospectus and incentive fee must be subject to a permanent “high water mark”</td>
<td>Permitted provided that the basis of calculation must be described in simplified prospectus and incentive fee must be calculated in reference to a total return benchmark or index</td>
</tr>
<tr>
<td><strong>Redemption of Securities:</strong></td>
<td>If disclosed in simplified prospectus, permitted to suspend redemptions for first 6 months after date of final simplified prospectus.</td>
<td>Redemption price must not be more than the NAV determined on a redemption date specified in the prospectus or annual information form.</td>
<td>Redemption price must be NAV next determined after receipt of the redemption order.</td>
</tr>
<tr>
<td></td>
<td>Otherwise, may redeem at NAV determined on the first or second business day after date of receipt of redemption order and pay redemption proceeds within 15 business days</td>
<td>Redemption proceeds must be paid no later than 15 business days after the valuation date on which the redemption price was determined.</td>
<td>Redemption proceeds must be paid within two business days after the determination of the redemption price.</td>
</tr>
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<td>Category</td>
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<tr>
<td>-----------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Custodial Arrangements:</td>
<td>Removes requirement for affiliates of domestic and foreign banks and trust companies to have “publicly available” financial statements showing minimum level of equity.</td>
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</tr>
<tr>
<td>Seed Capital:</td>
<td>$150,000 that may be redeemed once $500,000 from outside investors is received</td>
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</tr>
<tr>
<td>Ability to Charge Organizational Costs and Preparation of Initial Offering Documents to the Fund:</td>
<td>No</td>
<td>Permitted for exchange-traded mutual funds that are not in continuous distribution.</td>
<td>No</td>
</tr>
<tr>
<td>Offering Documents:</td>
<td>Simplified Prospectus, Annual Information Form and Fund Facts</td>
<td>Long Form Prospectus, Annual Information Form and Fund Facts/ETF Facts</td>
<td>Simplified Prospectus, Annual Information Form and Fund Facts</td>
</tr>
</tbody>
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AIMA Canada: Recommended MFDA Proficiency Standard for Approved Persons Selling Alternative Mutual Funds

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. 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 over 1,900 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2 trillion in assets under management. AIMA Canada, established in 2003, now has more than 140 corporate members.

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

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

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount investment exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Advisers and in many cases as Exempt Market Dealers. AIMA Canada’s membership also includes 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.
Section 4.1 of NI 81-104 sets out the proficiency requirements for both Approved Persons and their Supervisors applicable to trading in securities of alternative mutual funds.

Part 4 — Proficiency and Supervisory Requirements

4.1 (1) No mutual fund restricted individual shall trade in a security of an alternative mutual fund unless that individual:

(a) has received at least a passing grade for the Canadian Securities Course (CSC),
(b) has received at least a passing grade for the Derivatives Fundamentals Course, or
(c) has successfully completed the Chartered Financial Analyst Program.

Section 4.1(1)(d) of NI 81-104 contemplates that alternative mutual funds may also be distributed where the SRO of which the individual, or his or her organization, is a member has prescribed alternative proficiency standards and the securities regulatory authority or regulator has completed any required review, approval or non-disapproval of the regulatory instrument of the self-regulatory organization that establishes those proficiency standards.

Pursuant to Section 3.4(1) of NI 31-103 and MFDA Rule 1.2.3 (Education, Training and Experience), an Approved Person must not perform an activity that requires registration under securities legislation unless the Approved Person has the education, training and experience that a reasonable person would consider necessary to perform the activity competently, including understanding the structure, features and risks of each security that the Approved Person recommends.

Section 4.1 (2) further states: No principal distributor or participating dealer shall trade in a security of a commodity pool in the local jurisdiction unless the individual designated by the principal distributor or participating dealer to be responsible for the supervision of trades of securities of commodity pools in the local jurisdiction has received at least a passing grade for the Derivatives Fundamentals Course or has successfully completed the Chartered Financial Analyst Program.

There are important differences between conventional mutual funds and alternative mutual funds. Existing courses and examinations that may be used by mutual fund dealer staff responsible for supervising trades or Approved Persons to satisfy proficiency requirements under NI 81-104 do not adequately address the sale of alternative mutual funds. As a result, additional measures under Section 4.1(1)(d) of NI 81-104 must be prescribed by the MFDA in its capacity as SRO of Canadian mutual fund dealers and approved (or not disapproved) by the CSA to ensure that advice and transactions in respect of the supervision, purchase, and sale of alternative mutual funds provided by MFDA Members and their Approved Persons meet the general proficiency, experience and related requirements under NI 31-103 and MFDA Rule 1.2.3.

As they stand currently, the CSC, CIFC (Canadian Investment Fund Course offered by IFSE), Derivatives Fundamentals Course, and the Chartered Financial Analyst Programs do not sufficiently cover alternative mutual funds.
mutual funds to be considered appropriate proficiency though course amendments may be made to change this over time.