Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

Chairman
Gary Ostoich
Tel. (416) 601-3171

Deputy Chairman
Andrew Doman
Tel. (416) 775-3641

Legal Counsel
Michael Burns
Tel. (416) 865-7261

Treasurer
Chris Pitts
Tel. (416) 947-8964

Secretary
Paul Patterson
Tel. (416) 363-6526

Chief Operating Officer
James Burron
Tel. (416) 453-0111

www.aima-canada.org

March 8, 2013

John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Email: jstevenson@osc.gov.on.ca

Dear Sir:

Re: AIMA Canada's Comments on OSC Staff Consultation Paper 45-710 *Considerations for New Capital Raising Prospectus Exemptions* (the "Consultation Paper")

This letter is being written on behalf of the Canadian section ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the Consultation Paper.

We appreciate the opportunity to comment on the questions raised in the Consultation Paper and the opportunity that we had to meet with you to discuss it. We support the broadened scope of the Ontario Securities Commission's ("OSC") review of the exempt market regulatory regime and, in particular, the objectives of the policy review to consider how to best regulate the exempt market in a manner that:

- enhances its role in raising capital for businesses, particularly SMEs,
- provides retail investors with greater access to investment opportunities without compromising investor protection, and
- better aligns the interests of issuers and investors.

We applaud the efforts of the OSC to consult widely on these important topics, including the OSC public consultation sessions, and see this as building further on the work of the CSA in 2011 reviewing the Minimum Amount and Accredited Investor exemptions (CSA Staff Consultation Note 45-401). We particularly commend the research included in the Consultation Paper with respect to income levels in Ontario and Canada showing the number of potential investors at various income levels.

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 hedge fund, futures fund 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 1,330 corporate members, throughout 47 countries, including many leading investment managers, professional advisers and institutional investors. AIMA Canada, established in 2003, now has 80 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 hedge funds and fund of funds. Most are small businesses with less than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth individuals 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 exemptions. Manager members also have multiple registrations with the securities regulatory authorities; as Portfolio Managers ("PMs), Investment Fund Managers ("IFMs") and in many cases as Exempt Market Dealers ("EMDs"). AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

The comments in this letter have been written from the perspective of an AIMA member registered as an IFM, PM and EMD. It has been prepared by a working group of the members of AIMA Canada. For more information about AIMA Canada and AIMA, please visit our web sites at www.aima-canada.org and www.aima.org.

Comments

We refer to AIMA Canada's comments on CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions* dated February 28, 2012 ("AIMA Canada Comment Letter 2012" (attached for reference)) and wish to reiterate the Governing Principles stated therein. In our view these principles remain key in reviewing the proposals in the Consultation Paper as additional considerations for the raising of capital in Canada. In summary they are:

1. Investor Choice - Investors should have broad choice and access to a wide range of products and professional managers.

2. Investor Protection - The rules should include an element of investor

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

protection through regulation, recognizing ultimately that individuals are responsible for their investment choices.

3. Capital Raising - The rules should allow for efficiency in the raising of capital, while achieving a balance with investor protection.

4. Complexity - As new and innovative investment products are introduced to the market the regulatory regime should ensure that investors and their advisors can understand the products in which they invest.

These principles are expanded upon in AIMA Canada Comment Letter 2012 and below.

In the context of the Consultation Paper we would expand the Governing Principle with respect to Capital Raising. The OM prospectus exemption concept proposed in the Consultation Paper excludes investment funds. We believe that the concept should apply equally to investment funds for the following reasons:

a. Investment funds, particularly alternative funds not subject to NI 81-102, provide a broader range of investment choices to investors, consistent with Governing Principle #1 above.

b. Investment funds play a key role in the economy of gathering and pooling capital for investment. Not allowing investment funds to utilize an OM prospectus exemption impairs their ability to raise capital for further investment in the economy, likely reducing the size of capital flows to businesses.

c. Investment funds increase investor diversification and reduce risk by allowing an investor to achieve exposure to multiple companies selected by a professional portfolio manager. This compares to an annual limit of 4 companies under the crowdfunding and OM prospectus exemption concepts outlined, a concentration that increases investor risk.

d. Investment funds enhance investor protection since they are managed and advised by registrants with the professional qualifications to analyse and assess investments. The registrants are subject to a wide range of regulatory oversight and liability provisions for investor recourse exist.

We would add a 5th Principle: **Consistency of regulation across Canada**. This may be seen as part of Capital Raising but we include it separately for emphasis.

In our opinion it is absolutely critical to the effective functioning of Canadian markets that all participants (issuers, investors, registrants) face a consistent set of rules across the country. This clearly aligns with the Consultation Paper objective

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

of increasing the ability of businesses, particularly SME's, to raise capital. A multiplicity of regulatory requirements increases costs, which are a key factor for SME's seeking to raise capital.

Any attempted justification of different regulatory regimes between jurisdictions must be based on specific evidence of market differences and must not be due to philosophical differences in approach between CSA members. If specific differences cannot be identified then rules should be harmonized across Canada.

These governing principles inform our comments herein. We note that they align with the objectives of the policy review stated on page 1 above (and in section 1.2 of the Consultation Paper) and the Key Issues section (section 4) of the Consultation Paper (Greater access to the exempt market for issuers and investors; investor protections concerns and concerns regarding registrant conduct).

Outlined below are responses to questions in the Consultation Paper that we believe are most relevant to our members, as well as overall comments with respect to the proposed concepts.

Consultation questions and comments

Prospectus exemptions based on relationships with the issuer

Is the 50 security holder limit under the private issuer exemption too restrictive? If so, what limit would be appropriate? Please explain.

AIMA Canada agrees with the stakeholders noted in the Consultation Paper that consider the 50 security holder limit under the private issuer exemption to be too restrictive. We believe the limit could be increased, or indeed eliminated, without the issuer selling securities to the public. The exemption lists in detail the categories of potential private issuer security holders, obviating a need for a numerical limit.

Should the OSC consider re-introducing the closely held issuer exemption in addition, or as an alternative, to the private issuer exemption? If yes, should the conditions be changed?

AIMA Canada believes that capital raising should be efficient and that regulations which are harmonious across Canada significantly contribute to efficient capital raising. Accordingly the closely held issuer exemption should not be re-introduced in Ontario because it would not be consistent with other Canadian jurisdictions to do so. Also it would not, together with other reforms under consideration, add a significant additional basis for capital raising not otherwise

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

captured by the reforms under consideration.

Should the OSC consider adopting a family exemption that allows for securities to be issued to an unlimited number of family members of the directors, executive officers or control persons of the issuer or its affiliates? Please explain.

Yes. In accordance with our Governing Principles the OSC should implement section 2.5 of NI 45-106 in Ontario to ensure consistency of the regulatory regime across Canada. To the best or our knowledge no specific market differences have been identified that justify a different rule for Ontario.

OM Prospectus Exemption

Should an OM exemption be adopted in Ontario? If so, why?

AIMA Canada believes that an OM prospectus exemption should be adopted in Ontario, but it should not be linked with the crowdfunding proposal as it is in the Consultation Paper.

However, consistent with the Governing Principles outlined above, it should be harmonized with other CSA jurisdictions. Adding a 3rd type of exemption in Canada which is more restrictive, in addition to the B.C. and Alberta options, creates confusion and additional costs. In addition we note that more changes have been proposed by other CSA members. Such a range of approaches will not enhance an issuer's ability to raise capital; on the contrary it will make it more difficult and costly.

Additionally, for the reasons outlined above, any such exemption should be applicable to investment funds.

We strongly encourage the OSC to work with other CSA members to harmonize OM prospectus exemptions across Canada. In AIMA Canada's opinion the existing exemption in 45-106 should be the starting point as it is well understood in the industry.

Considerations for prospectus exemptions based on sophistication and advice

General questions

Would this exemption be useful for issuers, particularly SMEs, in raising capital?

AIMA Canada does not believe that this exemption would be particularly useful to investment funds given existing exemptions, nor, as noted in the Consultation

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

Paper, would it be likely to significantly increase the investor pool for issuers. We note that existing exemptions in NI 45-106 already cover many of the concepts proposed. In the interest of consistency and harmonization across Canada we would not support adding another Ontario specific exemption. Additional comments have been provided below in response to the questions, should the OSC decide to proceed with this idea.

Are there sufficient investor protections built into this exemption?

AIMA Canada believes that the provision of basic information and the requirement to sign a risk acknowledgement form together with a work experience and educational requirement is sufficient investor protection. For investment funds investor protection is further enhanced by the diversification provided by an investment fund, in combination with the NI 31-103 regime as explained more fully in AIMA Canada Comment Letter 2012.

Exploration of a prospectus exemption based on investment knowledge

Should we require an investor to satisfy both a relevant work experience condition and an educational qualification condition or would one suffice?

AIMA Canada agrees that it is difficult to define appropriate criteria of sophistication. If this exemption is pursued, AIMA Canada believes that both of the conditions should be required to be met.

How should we define the relevant work experience criteria?

AIMA Canada believes the one year work experience requirement should be defined to include work for at least one year in the financial sector or financial services support sector in a position that requires knowledge of investing. However, it could be difficult to define what is considered relevant. We note that the CSA recently felt it necessary to issue Staff Notice 31-322 to outline what it considered to be relevant investment management experience for advising representatives and associate advising representatives. Work experience for investment purposes would likely face similar difficulties.

What educational qualifications should be met? Should we broaden the relevant educational qualifications?

AIMA Canada believes that educational qualifications should be consistent with NI 31-103. In this way there is consistency within the industry. As the proposal stands, for example, a CA with the necessary industry experience could be the CCO of a registrant but would not be able to invest under this exemption. It is difficult to review and assess various educational qualifications and their

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

relevance. Since choices have already been made under NI 31-103 we believe that they should be maintained.

Exploration of a prospectus exemption based on registrant advice

AIMA Canada believes that a prospectus exemption based on registrant advice is entirely appropriate. As noted in the Consultation Paper such an exemption already exists in NI 45-106, with Ontario amending the exemption to exclude investment funds as a permissible investment.

Consistent with our Governing Principles we do not see any need for an additional exemption to be added. Rather, AIMA Canada believes that this is a key area for harmonization across Canada, and so **it would be appropriate that the existing managed account exemption be expanded in Ontario to permit purchases of securities of investment funds**. As noted in AIMA Canada's Comment Letter 2012 we submit that a policy basis for a regional distinction has not been established. Broadened access to managed alternatives increases investor choice and promotes investor protection by enabling diversification. Allowing reliance on this exemption in Ontario for the distribution of securities of investment funds is fully consistent with a portfolio manager's overriding fiduciary duty to act in a client's best interest.

In our opinion such a change would be the largest improvement to the exempt market in Ontario in pursuit of the OSC objectives.

We note that the OSC has granted exemptive relief from this provision since 2007 to accommodate exempt distributions in connection with the provision of portfolio management services to "secondary clients". These "secondary clients" are not accredited investors but are typically accepted because of the relationship between the "secondary client" and the "primary client" who qualified as an accredited investor. The exemptions have been granted in the past in order to accommodate smaller clients so that they can access an equivalent level of professional portfolio management services in a cost effective manner (to both the client and the portfolio manager). The OSC has typically considered the following when assessing these exemptive relief applications:

- the length of existence of the adviser;
- the ratio of registered PMs in the firm to separately managed accounts they manage; and
- the overall size of AUMs the advisers manage.

We understand that one of the key policy reasons for the exclusion of investment funds in paragraph (q)(ii) of the definition of "accredited investor" in NI 45-106 is to prevent the avoidance of the rules and regulations that are applicable to funds

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

offered to retail investors by distributing funds to them via fully managed accounts. Another concern we have heard is that where a portfolio manager has a multitude of managed accounts there is no true client relationship and therefore there is an increased risk of sales of securities of investment funds that may be inappropriate for the client.

To permit purchases of securities of investment funds under this exemption clarification language could be added to the Companion Policy to address the concerns. "Managed Account" for this purpose could be defined as a professionally managed personalized investment portfolio tailored to the specific individual needs of one or more account holders but excludes accounts, such as mutual fund or other investment fund accounts, which are professionally managed on behalf of many account holders without regard to the specific individual needs of each account holder. The OSC could consider delineating in guidance other hallmarks of true managed accounts such as the existence of a managed account agreement and broad discretionary investment authority which exists outside a mutual fund or investment fund structure. Such commentary would also include guidance as to what is considered to be an appropriate range of the number of managed accounts per PM, as has been acknowledged in grants of exemptive relief. AIMA Canada is conducting research to assess what is considered "best practice" and will forward it as soon as it is completed.

NEED FOR ADDITIONAL EXEMPT MARKET DATA

Are there any concerns with mandating use of the E-form?

AIMA Canada would support the implementation of electronic reporting of information, consistent with other reports. However it is important that any systems implemented be effectively tested and sufficiently resourced to ensure functionality, particularly around key submission dates. Until such systems are in place we do not believe that requiring the more frequent reporting of information is appropriate.

Are there any concerns with requiring this additional information in the report? Please explain.

AIMA Canada does not support the gathering of additional data through Form 45-106F1 at this time. In our opinion the current gathering of information is already diversified across several different initiatives, e.g. NRD, NI 33-109, Risk Assessment Questionnaires, Form 31-103F1 etc., which increases costs and frustration for registrants and prevents regulators from easily obtaining a complete view of information about a registrant and its activities. Collecting more data through another source exacerbates the problem.

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

Much of the information request outlined in the Consultation Paper with respect to registrants is already in the hands of the regulators and so we do not see any need for it to be repeated.

We strongly recommend that the CSA initiate a project to review and rationalize the collection of information from registrants via electronic means. The project would consider the following as part of its mandate:

a) Review the information requested and clearly outline why it is required and how it is to be used. This would include an assessment of the frequency of requiring updated information.
b) Review the costs to registrants and market participants of providing the information.
c) Conduct the appropriate cost/benefit analysis of the information in (a) and (b).
d) Define and build the required databases and information collection systems to electronically collect and consolidate the information.

AIMA Canada would be pleased to support and participate in such a project.

Conclusion

In summary we applaud the OSC's wide consultation on these important topics and the objectives set out in the Consultation Paper. We believe that the time is opportune to include in the review the fostering of efficient capital markets by including investment funds in the proposals.

AIMA Canada believes that in reviewing the proposals and comments received the OSC should consider the following important items:

A) Exemptions should be applicable to investment funds – As noted investment funds play an important role in the economy in aggregating capital for investment, providing professional management and investment decision-making and enabling investors to diversify risk.

B) Regulations must be harmonized across Canada – Regulations should be harmonized with other CSA jurisdictions in order to reduce costs and complexity. Differences should only be considered when there is specific evidence of market differences and must not be due to philosophical differences in approach between CSA members.

We appreciate the opportunity to provide the OSC with our views. Please do not hesitate to contact the members of AIMA set out below with any comments or questions you might have. We would be happy to meet with you in order to discuss

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

our comments further.

Gary Ostoich, Spartan Fund Management.
Chair, AIMA Canada
(416) 601-3171
gostoich@spartanfunds.ca

Ian Pember, Hillsdale Investment Management Inc.
Co-Chair, Legal & Finance Committee, AlMA Canada
(416) 913-3920
ipember@hillsdaleinv.com

Dawn Scott, Torys LLP
Co-Chair, Legal & Finance Committee, AlMA Canada
(416) 865-7388
dscott@torys.com

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

Ian Pember
On behalf of AIMA Canada and the Legal & Finance Committee

Alternative Investment Management Association (AIMA)
The Forum for Hedge Funds, Managed Futures and Managed Currencies

Chairman
Gary Ostoich
Tel. (416) 601-3171

Deputy Chairman
Eamonn McConnell
Tel. (416) 669-0151

Legal Counsel
Michael Burns
Tel. (416) 865-7261

Treasurer
Chris Pitts
Tel. (416) 947-8964

Secretary
Andrew Doman
Tel. (416) 775-3641

Chief Operating Officer
James Burron
Tel. (416) 453-0111

www.aima-canada.org

February 28, 2012

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903 Box 55
Toronto, Ontario M5H 3S8

c/o Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22 étage
C.P. 246, tour de la Bourse
Montreal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

Re: AIMA Canada's Comments on CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions* (the "Consultation Note")

This letter is being written on behalf of the Canadian section ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the Consultation Note.

We appreciate the opportunity to comment on the questions raised in the Consultation Note about the Minimum Amount and Accredited Investor Exemptions (the "MA" and "AI" Exemptions, collectively the "Exemptions"). We applaud the efforts of the CSA to consult widely on this important topic, especially the OSC consultation sessions held in February.

We also appreciate the opportunity that we had to meet directly with OSC staff to discuss our views.

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 hedge fund, futures fund 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 1,330 corporate members, throughout 47 countries, including many leading investment managers, professional advisers and institutional investors. AIMA Canada, established in 2003, now has 80 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 hedge funds and fund of funds. Most are small businesses with less than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth individuals 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 exemptions. Manager members also have multiple registrations with the securities regulatory authorities; as Portfolio Managers ("PMs), Investment Fund Managers ("IFMs") and in many cases as Exempt Market Dealers ("EMDs"). AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

The comments in this letter have been written from the perspective of an AIMA member registered as an IFM, PM and EMD. It has been prepared by a working group of the members of AIMA Canada. Input was also obtained directly from our members through an online survey. A summary of the key results of the survey is attached as Appendix A to this letter.

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

Comments

AIMA Canada's comments in this paper have been divided into three sections:

1. Governing Principles - This section outlines basic principles that we have used as a basis for our recommendations.

2. Recommendations - This section outlines recommendations as to the form the Exemptions should take.

3. Alternative Recommendations - This section outlines potential alternatives for the Exemptions.

Governing Principles

In determining our recommendations we considered the following principles:

1. Investor Choice - Investors should have broad choice and access to a wide range of products and professional managers.

2. Investor Protection - The rules should include an element of investor protection through regulation, recognizing ultimately that individuals are responsible for their investment choices.

3. Capital Raising - The rules should allow for efficiency in the raising of capital, while achieving a balance with investor protection.

4. Complexity - As new and innovative investment products are introduced to the market the regulatory regime should ensure that investors and their advisors can understand the products in which they invest.

Each of these principles is expanded upon below.

Investor Choice

In our opinion the investor regime should recognize the demographic trends in Canadian society of an aging population that will be increasingly in need of both investment management services and advice.

It has been well documented how the Canadian population has been aging.[1] Between 1971 and 2010 the median age in Canada increased from 26.2 years to 39.7 years. In 2010, an estimated 4.8 million Canadians, or 14.1% of the population, were 65 years of age or older. This number is expected to increase to 18.5% by 2021 and 22.8% by 2031, approximately double the current number. The aging population will increase the demand for professional investment management services and advice as people will have neither the expertise nor the inclination to manage their investments. AIMA Canada members are well qualified to provide such advice. It is important to note that within the broad population the Exemptions as currently drafted, particularly the AI Exemption, restrict the availability of investments offered without a prospectus to a very small subset of the

[1] Source: HRSDC calculations based on Statistics Canada. *Estimates of population, by age group and sex for July 1, Canada, provinces and territories, annual* (CANSIM Table 051-0001); and Statistics Canada. *Projected population, by projection scenario, sex and age group as of July 1, Canada, provinces and territories, annual* (CANSIM table 052-0005). Ottawa: Statistics Canada, 2010.

Canadian population.

Based on data from Statistics Canada[2] only 1% of Canadians meet the annual income threshold of $200,000. If the income threshold was increased to $250,000 almost one half of this group would cease to qualify. Conversely, if the income requirement was decreased to $100,000 over 5% of the population would qualify.

Similarly, approximately 1% of Canadians have financial assets that meet the AI Exemption threshold of $1 million.[3] If the financial asset threshold was increased to $1.5 million only about half of the current group of Canadians would continue to qualify. However, if the minimum financial asset requirement was decreased to $500,000 about 3.5% of Canadians would be able to invest based on the AI Exemption.

It is also important to note that total investments by Canadians in mutual funds, other investment funds and income trusts[4] have an estimated median value of $54,200 and an average value of $158,100 in total. These amounts indicate that investors' ability to utilize the MA exemption is very restricted as few meet the MA Exemption requirement of $150,000.

Given the above data we believe that a key objective of any review of the Exemptions should be to increase the availability of investment choices to as many Canadians as possible, consistent with investor protection (see below). This will allow them to increase their ability to support themselves in retirement and serve to lessen potential drains on government finances. We believe that increasing, or further restricting, the availability of investment options is contrary to the government's public policy objective of supporting Canadians ability to invest and grow their assets.

Investor Protection

We acknowledge that investor protection is a basic requirement of securities regulation. However, in determining an appropriate level of investor protection we submit that consideration should be given to the evolution of the securities regulatory regime in Canada.

When the Exemptions were first instituted in Canada (the MA Exemption in 1987 and the AI Exemption in the early 2000's) the regulatory regime applicable to our members' funds required the registration of advisors (portfolio managers) only. Ontario and Newfoundland and Labrador also required the registration of fund sponsors if they acted as market intermediaries as limited market dealers, which category of registration had no

---

[2] Source: Statistics Canada, CANSIM, table 111-0008. Last modified 2011-06-28.

[3] Source: Statistics Canada, Survey of Financial Security 2005. Combined results of tables that include bank deposits, mutual and other investment funds, bond, Canadian and foreign stocks, other financial assets, RRSP/LIRAs and RRIFs..

[4] Source: Statistics Canada, The Wealth of Canadians: An Overview of the Results of the Survey of Financial Security 2005 - Based on Table 4 and Table 5. Sum of investments in RRSPs, LIRAs, RRIFs and mutual funds/investment funds/income trusts. RRSP data includes investments in mutual funds etc.

[5] IOSCO Consultation Report CR03/12 – Suitability Requirements with respect to the Distribution of Complex Financial Products.

requirements with respect to proficiency, capital etc. Consequently investments in funds (and other privately placed securities) were sold across Canada under the Exemptions with limited regulatory oversight. The categories of EMD and IFM did not exist.

Given the perhaps limited role for a dealer on trades pursuant to the Exemptions, it is not surprising that the financial test thresholds for investors making investments pursuant to the Exemptions were set fairly high. This was done on the assumption that such investors:

a) Possessed a certain level of sophistication;
b) Had the ability to withstand the financial loss of the investment;
c) Had the financial resources to obtain expert financial advice if required; and
d) Had an incentive to carefully evaluate the investment given its size;

while recognizing that income or asset levels do not automatically mean that an investor has a certain level of sophistication.

However the regulatory regime has been greatly changed and enhanced with the introduction of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103") in 2009. With the implementation of NI 31-103 the investor protection regime across Canada was improved in the following key respects:

a) Creation of uniform national registration categories of PM, EMD and IFM to cover all aspects of the fund industry;
b) Enhanced proficiency requirements for all registrants;
c) Introduction of working capital and insurance requirements for all registrants;
d) Implementation of ultimate designated person and chief compliance officer requirements for all registrant firms, thereby enhancing the role and importance of the compliance function; and
e) Specific or increased regulatory requirements with respect to Know Your Client ("KYC") and Suitability requirements, as well as enhanced levels of relationship disclosure. Know Your Product ("KYP") requirements have also been enhanced.

While the list above is not exhaustive of all the improvements introduced, in our view the implementation of NI 31-103 greatly enhanced investor protection across Canada. As a result the management and any sale of interests in pooled funds by AIMA Canada members will generally involve firms registered in at least two of the categories of PM, dealer and IFM.

Given the above data we believe that any review of the Exemptions should recognize the regulatory framework established by NI 31-103 and its broad coverage of most aspects of the alternative investment industry. In our opinion it is important to recognize that a robust regulatory regime has been established which must be assumed to be functioning. We submit that regulatory concerns about registrants following the rules are monitoring and enforcement issues which should be viewed separately.

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

In addition to the above, we submit that, in assessing the level of investor protection, it is important to distinguish between products, e.g. pooled funds, in which the investor gets the benefit of professional management and the benefit of a dealer's KYC/suitability obligations, with the attendant reduction of risk, and those products which do not include similar professional investment management, e.g. a private placement of equity in a single company.

Capital Raising

As outlined by many participants during the consultation sessions held by the OSC in February, Canadian securities laws must strike a balance between providing investor protection and fostering markets that raise capital efficiently.

The ability to raise capital is crucial to the continued growth and prosperity of the Canadian economy. This ability is also critical in a world with global capital flows where funds will flow to wherever they can obtain the best return. Companies looking for investors should be able to access the broadest possible pools of capital at the lowest cost. In light of this we believe that the Exemptions must allow for the efficient flow of funds to the best investment opportunities without creating artificial barriers, especially through high minimum thresholds.

Complexity

We understand that the CSA has particular concerns about the use of the Exemptions for complex products. The investment market is innovative and continually developing new products. While the initial introduction of such products may be viewed as complex and difficult to understand, over time they tend to become commoditized and widespread and move into the mainstream.

In light of the typical product cycle it is difficult for anyone to set criteria for complexity and to determine whether an item is complex or not, thereby requiring special protection for investors through either restricted access or enhanced disclosure. The evolution of the Canadian investment fund industry's use of short selling is a perfect example. Initially mutual funds sold by prospectus to the public were prohibited from short selling securities. Then the regulators started granting exemptions from this prohibition, subject to application and certain disclosures being required. The latest step, effective April 2012 with amendments to National Instrument 81-102 *Mutual Funds*, is a general amendment that will allow mutual funds to short sell securities, subject to a cap of 20% of the net asset value of the fund, with required disclosures.

Given the above we believe that it is not reasonable to attempt to define complex products and treat them differently as a product's complexity will vary over time. The principle of disclosure, as has been required by Canadian regulators, should be followed to ensure that investors have the material that they, or their advisors, need to understand what they are purchasing We note that a focus on disclosure is the basic principle recommended by IOSCO in a paper recently released for comment[5].

Recommendations

AIMA Canada's recommendations for changes to the Exemptions are the following:

1. **Repeal the MA Exemption** - The minimum required investment amount of $150,000 per investment should be repealed.

2. **Amend the AI Exemption** - The financial thresholds used to determine an AI should be lowered.

3. **Standardize Exemptions Across Canada** - The rules should be standard across Canada in order to allow for efficiency in the raising of capital, while achieving a balance with investor protection.

4. **Certification of AI Status is not required** - Certification of an investors' AI status by an independent third party should not be required.

An explanation of each of these recommendations and our reasoning is below.

Repeal the MA Exemption

The establishment in 1987 of the limit of a minimum investment of $150,000 was arbitrary, as a proxy for sophistication, but does not actually provide any assurance of sophistication on the part of the investor. In the context of investment in pooled vehicles the minimum investment forces an investor to concentrate their investment in one strategy, thereby increasing risk, when the ability to diversify an investment of this size across several strategies would better serve the investor by reducing risk.

In our opinion the MA Exemption of $150,000 should be repealed. We believe that in most cases an investor who can afford to invest $150,000 in a single issuer is in all likelihood an accredited investor.

We submit that repeal of the MA Exemption, in conjunction with our other recommendations and alternatives outlined below, would increase the availability of investment choices for Canadians while maintaining an appropriate level of investor protection.

Amend the AI Exemption

Similar to the MA Exemption, the establishment in the early 2000's of the AI tests for individuals of $200,000 income or net financial assets of $1 million was somewhat arbitrary (although similar to levels used in other jurisdictions). In our view, the limits were set high, not unreasonably, given the lower level of regulation of the market at the time.

However, in our opinion the financial threshold tests for the AI Exemption, particularly if used in conjunction with an investment in an investment fund, should now be lowered, for example to annual income of $100,000 or net financial assets of $500,000. This would

increase the types of investments available to a bigger pool of Canadian investors, consistent with our view that these exemptions should increase the range of investments available to Canadians.

In our view any risk associated with broadening the pool of investors able to invest without a prospectus is offset by the improved regulatory regime of NI 31-103, which requires that an investment fund involve firms registered as IFMs, generally firms and individuals registered as dealers in one or more Canadian jurisdictions and, in most cases, firms and individuals registered as advisors. Dealers have KYP obligations; as well, in the context of individual investors, dealers or advisors will have KYC and suitability requirements to their clients.

Standardize Exemptions Across Canada

In our opinion there is no compelling local interest in the context of investment funds (as distinct from various industry sectors in different jurisdictions) that justifies a different exemption distribution regime in some Canadian jurisdictions from that available in others. The Ontario Securities Commission, in particular, has not adopted exemptions available to investment funds in other jurisdictions, while failing to articulate any basis for the position that regional differences across the country justify the availability of different exemptions in the interests of investor protection and fair and efficient capital markets. Policy differences between the regulators have not been expressed in plain language so that investors and industry participants can understand why investors in some jurisidctions are denied access to capital markets through investment funds on the same basis as is available in other parts of the country.

Accordingly, we recommend that the carve-out in the managed account exemption for Ontario (section (q) of the definition of accredited investor) be removed so that a fully managed account of an Ontario resident client managed by a PM is considered an accredited investor. This will increase the ability of companies to raise capital in Ontario and expand the investment alternatives available to Ontario residents. Our understanding is that this carve-out was originally instituted by the OSC because of concerns that the discretionary PM exemption might be abused. If the OSC has a concern about use of this exemption, we submit that it is more appropriately dealt with through the compliance and inspection process, rather than denial of the exemption to investment funds in Ontario. We also submit that given the enhancement to the requirements imposed on and regulation of registrants in NI 31-103, any historical concerns have been addressed.

Certification of AI Status

We do not believe that requiring certification of AI status by an independent third party is appropriate in today's market. It would add an unnecessary level of costs to the investment process in order to obtain such a certification. This is contrary to the basic principles of increasing access to investment products and improving the efficiency of capital raising.

The KYC and suitability requirements imposed on registrants, along with investor self

certification, should be sufficient. .

Summary
In summary, implementation of AIMA Canada's recommendations would:

a) Increase the range of investments available to a greater number of investors across Canada, thereby enhancing Canadians ability to invest in a diversified range of investments and plan for retirement;
b) Recognize the investor protection related improvements to the Canadian regulatory regime achieved through the implementation of NI 31-103; and
c) Improve the efficiency of the Canadian capital markets by having one set of rules nationwide.

Alternative Recommendations

If the recommendations above are not considered acceptable then AIMA Canada suggests the following amendments to the Exemptions:

1. MA Exemption Amount to be Lowered - Consideration should be given to lowering the amount below $150,000, or allowing it to be spread over several investment fund investments.

2. Different Criteria Depending on the Nature of the Investment - Consideration should be given to establishing different criteria for investments in investment funds (mutual or pooled funds) versus direct investments in other types of issuers.

3. Maintain the Status Quo - Maintain the MA and AI Exemptions in their current form.

Further explanations with respect to these alternatives are below.

MA Exemption Amount to be Lowered
If repeal of the MA Exemption is not considered appropriate then consideration should be given to implementing nationwide the Offering Memorandum exemption in section 2.9 of NI 45-106 permitting investment in investment funds on delivery of an offering memorandum in prescribed form and execution of a Risk Acknowledgement by the investor, already available in some jurisdictions. This suggestion would include the removal of the requirement to include financial statements in the offering memorandum of investment funds under continuous distribution, which we believe does not provide the investor with meaningful disclosure and adds unnecessarily to the volume of paperwork required for this exemption. Financial statements could be provided upon request, consistent with the regime set out in NI 81-106. We suggest that there has been time since NI 45-106 was implemented in 2005 to determine whether the exemption is being used inappropriately.

Alternatively the availability of the MA Exemption could be a function of the size of the

investor's portfolio with a maximum limit. For example, an individual could be allowed to invest the lesser of (i) $25,000; or (ii) a percentage (10% - 20%) of their investment portfolio. The latter could be either the investor's portfolio with the registrant or the investors's investment portfolio as documented through the KYC process or third party statements. In our opinion this is a particularly appealing option as it meets the objective of increasing choices available to Canadians while providing a level of investor protection by establishing a cap to possible losses.

Another alternative, if the carve-out in Ontario in section (q) of the definition of accredited investor is maintained, would be to allow a PM to spread its client's $150,000 over several pooled investments with the PM. This would have the benefit of allowing the PM to manage the portfolio with the appropriate risk reduction through diversification.

Different Criteria Depending on the Nature of the Investment

As outlined in our comments above with respect to Investor Protection, we believe that consideration should be given to establishing different criteria for investments in investment funds versus direct investments in other types of issuers. Investments in an operating business through a private placement, by their very nature, generally involve a higher degree of risk than an investment in a pooled fund that is diversified across multiple investments. We submit that the diversification provided by an investment fund, in combination with the NI 31-103 regime, should allow for reduced regulatory concern and hence a lower threshold for investors under the Exemptions, or their replacements. Investors in direct private placements in a single company might continue to be required to meet the current thresholds in recognition of the greater inherent risk. While we note that some of the private placement exemptions are premised on there being greater risk in the case of investments through investment in investment funds, i.e. the carve-out for Ontario in section (q) of the definition of accredited investors, or redeemable investment funds not offered by prospectus in section 2.9 of NI 45-106, we submit that a policy basis for these regional distinctions has not been established. We submit that in the context of the current economic conditions, where traditional equity and debt markets are under performing, the use of managed alternatives is appropriate. Rather than increasing risk, investment fund investments may in fact may have the result of reducing investor risk and enhancing investor protection against unfair, improper and fraudulent practices.

Maintain the Status Quo

In our opinion, if the recommendations above are not implemented, there is no acceptable reason to increase the thresholds in the Exemption as some have advocated. As we have outlined above the pool of potential investors under the existing Exemptions is already very small. It should not be further restricted. Although the thresholds are arbitrary they are well established and well known. AIMA Canada does not see any need to adversely change current business models by increasing them.

We note that some of impetus for an examination and possible changes in the Exemptions is derived from comparisons to other advanced securities markets. As stated in the Consultation Note, Australia has higher limits, but those of the UK and US are similar to

the current Canadian requirements. In our view the US requirements are the most relevant, particularly in the context of raising capital in a competitive market. We note that the US is only now moving to a regulatory regime similar to Canada's, i.e. requiring more advisors and investment funds to register and making the AI asset test a test of financial assets by removing an investor's principal residence from the calculation.

Conclusion

In conclusion AIMA Canada believes that any review of the Exemptions should be based on the following principles:

1. Investor Choice - Investors should have broad choice and access to a wide range of products and managers.
2. Investor Protection - The rules should include an element of investor protection through regulation, recognizing ultimately that individuals are responsible for their investment choices.
3. Capital Raising - The rules should allow for efficiency in the raising of capital, while achieving a balance with investor protection.
4. Complexity - As new and innovative investment products are brought to market the regulatory requirements should be designed to ensure that investors and their advisors can understand the products in which they invest.

We appreciate the opportunity to provide the CSA with our views on the Consultation Note. Please do not hesitate to contact the members of AIMA set out below with any comments or questions you might have.

Gary Ostoich, Spartan Fund Management.
Chair, AIMA Canada
(416) 601-3171
gostoich@spartanfunds.ca

Ian Pember, Hillsdale Investment Management Inc.
Co-Chair, Legal & Finance Committee, AlMA Canada
(416) 913-3920
ipember@hillsdaleinv.com

Dawn Scott, Torys LLP
Co-Chair, Legal & Finance Committee, AlMA Canada
(416) 865-7388
dscott@torys.com

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

Ian Pember
On behalf of AIMA Canada and the Legal & Finance Committee

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

AIMA Canada Summary of Survey Results

Outlined below are highlights of the results of a survey of AIMA Canada members conducted in January/February 2012. The questions were based on the CSA Consultation Note.

Question	Summary of Responses
Member profile - Size and business profile	-50% manage $50 million AUM or less -Majority are subject to regulation by OSC -Over 80% have less than 20 employees -Over 80% have greater than 50% of their business with high net worth individuals -Over 80% of business relies on the Accredited Investor exemption
Minimum Amount exemption of $150,000	-Over 60% believe that the exemption should be repealed or eliminated -This view does not change due to complexity, disclosure or suitability requirements
Impact of changing the Minimum Amount exemption	-If the exemption was increased to $250,000 this would have a negative impact on the business of over 70% of respondents -If the exemption was decreased to $50,000 this would have a positive impact on the business of over 70% of respondents
Accredited Investor exemption of $200,000 annual income or $1 million of net financial assets	-Over 65% believe that the exemption amounts should be adjusted downwards or changed - This view does not change due to complexity, disclosure or suitability requirements
Impact of changing the Accredited Investor income exemption	-If the exemption was increased to $300,000-$400,000 this would have a negative impact on the business of over 80% of respondents -If the exemption was decreased to $100,000-$150,000 this would have a positive impact on the business of over 70% of respondents
Impact of changing the Accredited investor asset exemption	-If the exemption was increased to $1.5-$2.0 million this would have a negative impact on the business of over 70% of respondents -If the exemption was decreased to $250,000-500,000 this would have a positive impact on the business of over 70% of respondents
Should 3rd party certification of Accredited Investor status be required?	-Over 90% indicated that this should not be required.

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**