July 27, 2004

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

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- and -

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Re: Changes to Proposed National Instrument 81-106 – Investment Fund Continuous Disclosure

General

Canadian members of the Alternative Investment Management Association **("AIMA")** hereby offer comments with respect to the Canadian Securities Administrators ("**CSA**") proposed changes to National Instrument 81-106 Investment Fund Continuous Disclosure ("**NI 81-106**") published May 28, 2004.

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 educational and research body that specifically represents practitioners in hedge-fund, futures fund and currency fund management- whether managing money, providing a service such as prime brokerage, administration, legal or accounting. AIMA's global membership comprises over 580 corporate members including many of the leading investment managers, professional advisors and institutional investors. AIMA's Canadian chapter, established in 2003, now has over 52 corporate members.

One of the objectives of AIMA is to ensure the representation and integration of skill-based investments into mainstream investment management. AIMA works closely with regulators and interested parties in order to better promote and control the use of alternative investments.

Overview

As in our previous submission in respect of the first draft of NI 81-106, our comments are particularly focused on the impact that NI 81-106 will have on private hedge funds and private "fund of fund" hedge fund structures offered to accredited investors and other exempt purchasers who are deemed by applicable securities laws to have a sophisticated level of knowledge in order to permit them to make and/or evaluate their investment decision. Although we recognize that private funds are exempt from a number of the provisions of NI 81-106, the issues discussed below relating to the compressed time periods for the preparation of the financial statements of "public" mutual funds are also generally applicable to private funds, and we reiterate our concerns in that regard.

Our previous submission addressed general questions which had been posed by the CSA when NI 81-106 was first published for comment. We appreciate the time the CSA has taken to consider our responses and to reflect certain of our concerns in this revised draft of NI 81-106. However we have some continuing concerns which are set out in this letter. We will attempt to provide more specific comments on the current draft in the context of our more general concerns.

Definitions and Application

Section 1.1. We believe that having different definitions for "non-redeemable investment fund" depending on the jurisdiction of formation or residency could lead to confusion as to the application of the Instrument, especially in light of your comment that the definitions are intended to be substantively the same. Each incorporates the concept

of pooling for investment and the inability to redeem on demand (or within a specified period following demand) at net asset value, however the non-Ontario version emphasizes the passive nature of the investors' investment in the Fund while the Ontario version emphasizes the passive nature of the Fund's portfolio investments. This could result in an uneven playing field for those investment funds which take an active role in the management of investee companies, depending on the residency of the fund.

Section 1.2. Although we recognize that the application or non-application of NI 81-106 to non-reporting issuer mutual funds reflects local securities acts, we believe that an Instrument of this nature that is intended to harmonize securities regulation in Canada ought to have fewer, or no, jurisdictional "carve-outs" as this leads to an uneven playing field for participants. We appreciate the attempt to address this in part by providing some relief from certain provisions (for example the filing requirement exemption set out in section 2.11) however this adds unnecessary complexity to the Instrument.

Filing Deadlines for Interim and Annual Statements

Sections 2.2 and 2.4. Although we appreciate the transitional period for implementation of the shortened reporting time frames (of 90 days and 45 days for the filing of annual and interim financial statements, respectively), we reiterate our earlier concerns of the potential impact that shortened periods will have on our members. In our experience, the process of preparing financial statements is already difficult under the existing deadlines and will become even more so with the shortened time periods contemplated by NI 81 – 106. In some cases it will not be possible to meet the time frames. Many fund of fund hedge funds have underlying funds located outside of North America. Accordingly, the delivery of financial statements by the underlying funds can exceed 120 days, thereby further delaying delivery of financial statements by the Canadian based of funds. In other cases, these compressed time periods may result in more "timely" financial reporting but not necessarily better financial reporting. We believe that the CSA's objective of improved financial reporting is at odds with this requirement for faster reporting. In fact, we are concerned that these shorter deadlines may result in a greater number of errors as a direct result of the requirement to meet unrealistic deadlines. The process of preparing, producing and delivering financial statements (especially for smaller hedge funds) is a significant undertaking and we encourage the CSA to recognize that several aspects of this process are not within the control of the investment fund.

Sections 2.9. We question the utility of imposing reporting issuer requirements on a non-reporting issuer investment fund as they relate to a change in year end. This adds additional regulatory burden (especially to relatively small hedge funds), and will lead to greater accounting and legal costs to such funds.

Section 2.11. We appreciate the CSA's accommodation of our concern that in many cases our member funds' financial information, and in particular the statements of investment portfolio, reveal proprietary investment strategies and trading patterns. Not requiring non-reporting issuer mutual funds to file statements on the public record will assist to some extent. However, we continue to have a concern about the requirement

even to deliver a statement of portfolio to our security holders, especially given that member firms will be required to do so in much tighter timelines. This will be particularly problematic with respect to the reporting of short positions.

We believe that the requirement in NI 81-106 for disclosure of portfolio holdings in a fund's interim and annual financial statements will have an adverse effect on private hedge funds due to the fact that, in many cases, the strategies employed are based on proprietary research which is often reflected in the securities purchased. Requiring disclosure of a private hedge fund's portfolio holdings in the manner contemplated by NI 81-106 will require the managers of such hedge funds to reveal investment allocations and, over the course of time, show trends in trading practices which could negatively affect their ability to pursue these strategies on a going forward basis. This is already an area of concern to the industry with the currently existing semi-annual and annual reporting. In addition, it is unclear as to how the proposed disclosure of portfolio holdings would apply to private fund of funds hedge funds where some (or all) of the underlying hedge funds within the fund of funds are formed outside of Canada and therefore are not subject to the same disclosure requirements for their portfolios. The reporting of portfolio holdings by Canadian hedge funds would be unique on the international landscape and would prejudice Canadian hedge funds and their investors relative to other funds established outside of Canada.

The requirement to report short positions could be particularly damaging if such disclosure is made while those short positions are still in place. The combination of a known short position and, for example, a known "stop-loss" investment mandate, could lead to abuse by other industry participants. This risk will be exacerbated by the shorter reporting timelines. Also, the ability of others to engage in practices akin to front-running (by anticipating fund trades and trading in securities ahead of the investment fund) and/or free riding (building a portfolio which is the same as that disclosed by the investment fund) will both have the effect of reducing certain hedge funds' competitive advantage. Ultimately these practices may result in higher prices for the securities purchased by the hedge funds, lower prices in the sale of securities held by the fund and will allow others to achieve the benefit of professional investment management and research which is paid for by the security holders of the hedge funds. We believe that any perceived benefits to unitholders of this type of disclosure could be greatly outweighed by the costs and disadvantages to the fund.

Section 2.12. Smaller funds that are less likely to have the financial resources to engage an auditor to perform a review of the interim financial statements will be put at a competitive disadvantage. The public may draw unfair inferences from a disclosure statement indicating that an auditor was not engaged to perform a review. Also, with the tighter time constraints, the cost of having an audit review conducted is likely to increase, adding even more operational expenses to an investment fund.

Subsection 3.2(1). Item 12 of subsection 3.2 (1) should read "dividends **paid** on securities sold short" instead of "dividends received on securities sold short". Also, item 14 requires disclosure in the Statement of Operations of amounts that would otherwise

have been payable by the investment fund that were waived or paid by the manager or a portfolio adviser of the investment fund. As we set out in our earlier submission, we believe that it is incorrect to require that waived expenses be included in fund results. By definition they are not part of the fund's results. This inclusion would be inconsistent with the section 15.1 requirement to calculate a management expense ratio as reported, and a separate management expense ratio as if the waived expenses had been incurred. We are not opposed to including such information in a note to the Statement of Operations.

Subsection 3.6(1). Item 5 of subsection 3.6(1) requires a breakdown of the services received in consideration of the management fees, as a percentage of management fees. We believe that this item requires more clarification. If the manager is providing a basket of services to the fund, it is artificial at best to apportion a percentage of the fees paid to the manager for each of the enumerated items. It may be helpful to our members to understand why this disclosure is required.

Subsection 3.6(2). We assume but require clarification that borrowings include margin.

Section 7.4 In light of the results of the COMPAS survey which indicated that a majority of investors are satisfied with the current reporting, we are at a loss to understand why the current practice of combining financial results of a family of funds in a tabular format is not acceptable to the CSA. Section 7.4 will require a complete separate set of financial statements for each fund, which we believe may increase the cost of preparation, production, printing and mailing. We believe that this provision mitigates against efficiency and investor desire for shorter/smaller reports.

Part 10. The requirement to include proxy voting disclosure could result in a significant workload for hedge funds with little value in return to its investors. Although we understand that it mirrors the U.S. requirements for the mutual fund industry, we believe that if it is applied to certain Canadian hedge funds it will put those hedge funds at a competitive disadvantage. We are encouraged by the fact that it does only apply to reporting issuers and that it need only be sent to security holders of the investment fund who request same.

Part 15. If the one reported management expense ratio is to include performance fees, we believe that this will shed an unnecessarily negative light on strong, performing funds. Management expense ratio is intended to indicate to investors the indirect cost to them of investing in the fund. If one fund has a management expense ratio of 5%, which will apply whether the fund does very well or very poorly, it could be misleading to investors to require another fund which has a "fixed" MER of, for example, 2% but because of performance fees would have to report a MER, for example, 15% in a year when it does exceptionally well. Investors may be misled into thinking that the 15% MER will apply even in a year in which the fund loses money. We question whether investors reviewing the listing of management expense ratios in a newspaper or other reporting services will understand this distinction. We are not opposed to publishing an

all-in expense ratio in the financial statements of the fund, however we are opposed to requiring investors to compare apples to oranges by requiring performance fees to be included in a fund's management expense ratio.

Conclusion

We appreciate the opportunity to provide the CSA with our views on this proposal. Please feel free to direct any questions or comments that you might have to any of the following members: Jim McGovern, Arrow Hedge Partners Inc. (416) 323-0477, David Jarvis, Blair Franklin Capital Partners Inc. (416) 368-1211, Ian Pember, Hillsdale Investment Management Inc. (416) 913-3920, Ron Kosonic, Aird & Berlis LLP (416) 865-7776, or Gary Ostoich, McMillan Binch LLP (416) 865-7802.

Yours truly,

David Jarvis
Vice Chairman,
AIMA Canada