Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

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April 10, 2012

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Dear Sirs/Mesdames:

Re: Multilateral Instrument 32-102 Registration Exemptions for Non-Resident Investment Fund Managers and Companion Policy 32-102CP Registration Exemptions for Non-Resident Investment Fund Managers (collectively, "MI32-102"), published by the Ontario Securities Commission, the Autorité des marchés financiers, the New Brunswick Securities Commission and the Financial Services Regulation Division, Service NL, Government of Newfoundland and Labrador (the "Jurisdictions")

Multilateral Policy 31-202 Registration Requirement for Investment Fund

Managers ("MP31-202"), published by the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Financial Services Commission, the Manitoba Securities Commission, the Registrar of Securities, Prince Edward Island, the Nova Scotia Securities Commission, the Registrar of Securities, Northwest Territories, the Superintendent of Securities, Yukon, the Registrar of Securities, Nunavut (the "Alternative Jurisdictions")

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 legislation referred to above.

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 over 80 corporate members, which include some of the largest institutional investors in Canada.

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; 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. They 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 the funds are typically sold under prospectus exemptions. Members also have multiple registrations: as portfolio managers, investment fund managers, and in many cases as exempt market dealers. The membership also includes accounting 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 www.aima-canada.org and www.aima.org.

Comments

AIMA supports the activities of the Canadian securities regulators to enact appropriate levels of regulation and acknowledges the mandate of the securities regulatory authorities in the Jurisdictions to provide protection to investors from unfair, improper or fraudulent

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practices. We also recognize that certain risks associated with the functions and activities of non-domestic investment fund managers give rise to investor protection concerns, in the same manner as domestic investment fund managers with a place of business in the local jurisdiction.

However, we do not support the approach taken by the Jurisdictions in MI32-102 and strongly favour the approach taken by the Alternative Jurisdictions. It is our view that the approach of the Alternative Jurisdictions fits squarely within the legislative framework for the regulation of securities in Canada while the approach of the Jurisdictions does not. We also believe that approach of the Alternative Jurisdictions effectively balances the competing mandates of investor protection with the promotion of fair and efficient capital markets. The approach of the Jurisdictions does not.

Jurisdictional Issue

We submit that, as a consequence of the *Constitution Act, 1867*, the Jurisdictions only have the authority to regulate investment fund managers who conduct business within their physical jurisdiction. We note that recent jurisprudence addressing the issue of jurisdiction indicates that

> "... a province is not limited to protecting the interests of domestic investors from unfair or fraudulent activities. Provincial securities legislation can also be applied to regulate corporations or individuals within the province in order to protect investors outside the province from unfair, improper or fraudulent activities. Where the Commission is regulating trades that have an extraprovincial character, the question is not the location of the investors; rather, it is whether there is a sufficient connection between Ontario and the impugned activities and the entities involved to justify regulatory action by the Commission".[1]

We observe from this case that the question of a connection to the jurisdiction is relevant, and that the location of investors alone is not a sufficient connection.

It is our view that the following functions and activities listed in MP31-202 are undertaken or directed by investment fund managers at or from their head office or principal place of business, which for non-domestic investment fund managers is not in the jurisdiction of residence of fund investors: (i) establishing and overseeing the fund's compliance and risk management programs; (ii) overseeing the day-to-day administration of the fund; (iii) retaining and liaising with the portfolio manager, the custodian, the dealers and other service providers of the fund; (iv) overseeing advisers' compliance with investment objectives and overall performance of the fund; (v) preparing the fund's prospectus or other offering documents; (vi) preparation and delivery of security holder reports; (vii) identifying, addressing and disclosing conflicts of interest; (vii) calculating the net asset value (NAV) of the fund and the NAV per share or unit; and (viii) calculating, confirming

[1] Crowe v. Ontario Securities Commission 2011 ONSC 6918.

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and arranging payment of subscriptions and redemptions, and arranging for the payment of dividends or other distributions, if required.

We note that in the context of reporting issuers, securities legislation recognizes that the delivery of security holder reports (item vi above) and the payment of subscriptions, redemptions and dividends (item ix above) by non-Canadian issuers to Canadian residents do not alone trigger the application of the securities legislation applicable to reporting issuers. This legislation implicitly recognizes that these activities do not occur in the jurisdiction in which the investors of the issuer reside. It is not appropriate that this concept be applied in a different manner for investment funds.

We agree that (i) establishing a distribution channel for the fund and (ii) marketing the fund are functions and activities are undertaken by investment fund managers in the jurisdiction of investors. However, in our view these activities alone do not constitute a sufficient connection to warrant triggering the investment fund manager registration requirement.

We do observe that distribution and marketing activities do trigger the dealer registration requirement.

We also refer to section 8.5 of NI31-103CP in which commentary is provided on the dealing activities of non-domestic dealers in Canada. This guidance suggests that marketing activities of non-domestic entities in Canada trigger the dealing registration requirement, not the investment fund manager registration requirement. We observe that should distribution and marketing functions trigger the investment fund manager registration requirement (which does not contain an "in the business" threshold), then all non-domestic dealers distributing and marketing investment fund products in Canada would trigger the investment fund manager registration requirement.

We acknowledge that the Jurisdictions responded to previous comments on this point. We submit that the Jurisdictions' response to comments, reproduced below, addresses the Jurisdictions' public protection concern but is entirely non-responsive to the point in issue, namely that the dealer registration requirement and the investment fund manager registration requirement, as set out in securities legislation, describe entirely different activities. We urge the Jurisdictions to provide a fulsome explanation of the rationale for their views.

> "We are of the view that although we have dealer registration and prospectus requirements, these requirements do not provide the same ongoing protections or address the same risks that the proposed amendments to the investment fund manager registration requirements aim to achieve."

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[2] 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.

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We note that MI32-102CP indicates that the existence of a referral arrangement between an investment fund manager and a third party which makes purchase recommendations where compensation is paid when a recommendation is made constitutes active solicitation and disentitles an investment fund manager from relying on the exemption in proposed MI32-102. In our view, the mere existence of a contractual relationship with an entity in a jurisdiction does not constitute a sufficient connection to the jurisdiction to trigger the investment fund manager registration requirement, and cannot be characterized as "active solicitation". We query whether it is the view of the Jurisdictions that a referral arrangement of this type also triggers the dealer registration requirement. In any event, because compensation in referral arrangements is generally triggered by an investment being made, not merely a recommendation to buy, it is not clear to us the exact nature of the activity that the Jurisdictions consider "active solicitation" in these circumstances.

Absence of Grandfathering

We note that the exemption in section 3 of MI32-102 requires that "the investment fund or the investment fund manager has not actively solicited residents in the local jurisdiction to purchase securities of the fund". The result of this language will be that investment fund managers whose funds have accepted Canadian investors as a result of "active solicitation" prior to the enactment of MI32-102 will not be able to rely on this exemption. The managers of these investment funds who are not able to meet the required registration requirements or who choose not to register will need to force the redemption of Canadian investors' positions in the investment funds they manage. We urge the Jurisdictions to re-insert grandfathering provisions contained in previously published draft legislation on this subject.

Required Reporting by International Investment Fund Managers

We oppose the requirement that unregistered investment fund managers relying on MI32-102 be required to disclose total assets under management attributable to security holders in the local Jurisdiction. This information is proprietary to investment fund managers and their investment funds and, even if provided on a confidential basis, could be subject to disclosure pursuant to a freedom of information request. We query why the Jurisdictions desire this information given that the right to rely on the exemption is not subject to review by the Jurisdictions if the pre-requisites of the exemption are met. We also note that "international dealers" and "international advisers" are not required to provide this information. No policy basis for the need for this information in the context of investment fund managers, but not international dealers and international advisers, is given.

Notice to Investors

In connection with the cautionary language required by section 5 of MI32-102 to be provided to investors, we note that as investors have no privity of contract with an investment fund manager (in its capacity as such) and likely no common law cause of action against the investment fund manager, it is our view that the cautionary language is misleading to investors as it infers that the investor may have rights against the investment

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fund manager. In this regard, we are cognisant of section 116 of the *Securities Act* (Ontario), but note that the statutory standard of care in the section is owed to the investment fund and not individually to an investor in the fund.

Market Impact

We urge the Jurisdictions to re-consider the impact of MI32-102 on Canadian investors. It is our strong expectation that the vast majority of non-Canadian investment fund managers will choose not to register as investment fund managers in Canada and will rely on the exemption set out in section 4. As a consequence, investments in non-Canadian investment funds will be limited to "permitted clients".

We note that based on data from Statistics Canada[2], only 0.13% of the population have assets in excess of $2.5 million. Consequently, less than 0.13% of Canadians can be considered to have net financial assets in excess of $5 million and constitute "permitted clients". Based on these statistics, if MI32-102 is implemented, direct investments in non-Canadian investment fund products will only be available to a tiny portion of individual Canadians. Access to investment products managed by non-residents, seen as key to risk diversification, will be denied to the vast majority of Canadians.

In addition to the impact on individuals, in our view non-resident investment fund managers may be unwilling to comply with the conditions of the Instrument, in particular the Notice of Regulatory Action. The result will be that Canadian institutional investors, e.g. pension plans or investment funds, may be denied access to non-Canadian funds, including exchange traded funds.

We do not believe that this result fosters fair and efficient capital markets.

Non-Harmonized Legislation

We urge the Jurisdictions and the Alternative Jurisdictions to implement the requirements for investment fund manager registration in identical form. We submit that it is imperative that staff in each jurisdiction reach consensus with respect to their interpretation of the investment fund manager registration requirement and the dealer registration requirement. The differing legal conclusions of the Jurisdictions and the Alternative Jurisdictions with respect to the same legislation will generate substantial uncertainty and confusion in the Canadian capital markets. While we believe that local distinctions in legislation may be maintained if there is a substantive and compelling basis for the distinction, we see no reasonable rationale for jurisdictions to apply different legal conclusions to the same legislation in this context.

The existence of such radically different regulatory requirements within Canada is totally contrary to the recent arguments put forward by various provinces in the reference to the Supreme Court of Canada with respect to the establishment of a national securities regulator. Differing regimes hurt Canada's international reputation as a jurisdiction for

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business.

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

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Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

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