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The Forum for Hedge Funds, Managed Futures and Managed Currencies

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September 12, 2012

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Dear Sirs/Mesdames:

Re: AIMA Canada's Comments on Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* relating to Cost Disclosure and Performance Reporting

This letter is being written on behalf of the Canadian National Group (**"AIMA Canada"**) of the Alternative Investment Management Association (**"AIMA"**) and its members to provide our comments to you on the Canadian Securities

Administratorsô (**"CSA"**) proposed amendments (the **"Proposals"**) to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**"NI 31-103"**) and Companion Policy 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the **"Companion Policy"**) relating to proposed cost disclosure and performance reporting requirements.

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 ï whether managing money or providing a service such as prime brokerage, administration, legal or accounting. AIMAôs global membership comprises over 1,250 corporate member firms (with over 5,500 individual contacts) in more than 40 countries, including many leading investment managers, professional advisers and institutional investors. AIMAôs Canadian national group, established in 2003, now has over 90 corporate members.

The principal aims of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industryôs future development; to be the pre-eminent voice of the industry to the wider financial community, institutional investors, the media, regulators, governments and other policy makers; and to offer a centralized source of information on the industryôs activities and influence, and to secure its place in the investment management community.

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

This comment letter has been prepared by a working group of the members of AIMA Canada, comprised of managers of hedge funds and fund of funds, and accountancy and law firms with practices focused on the alternative investments sector.

Comments

AIMA Canada supports the objective of ensuring that clients of all dealers and advisers receive clear and complete disclosure of all charges associated with their accounts and meaningful reporting of how their investments perform.

We appreciate the clarifications that have been made to the original proposals made in 2011, specifically:

- That non-individual permitted clients are excluded from the requirements;
- That the registrant with the client facing relationship is responsible for

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performance reporting;

- That both performance reporting and client statements are to be on an account basis, unless a client agrees otherwise;
- That the timing for reporting is to be on a regular firm wide cycle and not driven by a client anniversary;
- The removal of ñnet amount investedò as the starting point for calculating the change in value of a clientôs account; and
- The replacement of original cost with book cost

However we continue to have some concerns over the revised proposals as outlined. We have reviewed the proposals carefully and have outlined below our comments for your consideration.

Percentage Return Calculation Method

The Proposals mandate that the calculation of client returns for the investment performance report be prepared using the dollar weighted return method (ñDWRò). The stated objective for this mandate is ñto promote consistency and comparability in investor reporting from one registrant to another.ò The Request for Comment also states ñWe expect that providing investors with clear and meaningful investment performance reporting will assist them in making decisions about meeting their performance goals and objectives, and in evaluating the investment advice they receive from their registrants.ò

In our opinion the mandating of the use of DWR does not meet these objectives, primarily due to the fact that dollar weighted returns can be materially impacted by the timing and amount of investor additions to or withdrawalôs from an account, in conjunction with the direction and magnitude of market direction. Such investment decisions are beyond the control of the registrant managing the account.

We submit that due to this weakness the ability and skill of a registrant to help a client achieve their goals is obscured as the amount of the return attributable to the registrantôs skill cannot be distinguished. Thus an investor cannot readily evaluate the investment advice received. Since the return of any given account using DWR is impacted by cash flows, which will differ between accounts held by an investor at various registrants, there is no real comparability between the results achieved by two or more different advisors.

As noted in the discussion in Appendix A to the Proposals ñTime weighted methods are generally used to evaluate the registrantôs performance in managing an account.ò Usage of a time weighted return method (ñTWRò) would thus meet the stated objective of promoting consistency and comparability between registrants

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and would allow investors to evaluate the investment advice received. In this way an investor can make better decisions in how a registrant is helping them to achieve their investment goals.

As an example of the potentially misleading results that could arise from using DWR, consider a situation where the same registrant manages both a RRSP and a non-registered account for a client. Both accounts are managed using the same strategy and employ identical investments. If there are differing cash flows (amount or timing) into the two accounts, for example a monthly RRSP contribution and an annual bonus into the non-registered account, using DWR will yield differing returns for the two accounts. This seems obviously wrong since the 2 accounts were managed using the same strategy. TWR would reflect the same returns for both accounts, which would be correct and a reflection of what the registrant achieved for the client.

We also note that mandating the use of DWR potentially creates a professional conflict for portfolio managers, the vast majority of whom in Canada are CFAs (as required by regulation). The CFA Institute, through the Global Investment Performance Standards (ñGIPSò), has mandated globally that TWR is the methodology to be used when analysing or presenting returns to investors. This conclusion was reached after many years of professional debate worldwide. GIPS are considered to be the gold standard globally for measuring investment returns and have been implemented in over 30 countries.

If DWR were to be mandated then portfolio managers would be professionally required to present returns using TWR as well. In our view this would lead to investor confusion, the obvious question being ñWhich is the real return?ò

Using DWRõs would be inconsistent with returns presented in investor letters, Management Reports of Fund Performance under NI 81-106 (the 81-106F1) and in Annual Information Forms under NI 81-101 (the 81-101F2) etc. Since cash flows cannot be assumed for such reporting, any presentation of returns is by definition calculated on a TWR basis. This could result in a situation where an investor receives a report or management discussion quoting a 1 year return and at the same time receives a performance report quoting a different 1 year return.

Any comparisons to a benchmark are by definition a comparison to a TWR as well.

Lastly, we believe that TWR is the methodology currently used by the majority of registrants, or certainly by our members. A switch to DWR, or its addition to reporting, could have significant cost and technology implications for registrants, as well as creating investor confusion upon suddenly seeing another set of return

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numbers. There are also implementation issues (see below).

Given the above we recommend that, if a single methodology is to be mandated in the interest of comparability, then the methodology should be TWR. However, we believe that an advisor or dealer should be allowed to utilize a generally acceptable method that meets their clientôs needs.

Performance Reporting Implementation

The Proposals currently allow for the investor performance report to be implemented in stages, commencing after 3 years. Five and ten year returns would only be required to be reported as those periods are reached post implementation.

However, clients expect reporting from their registrants to continue, irrespective of such regulatory requirements. If a registrant has had a client for several years (say 7 years) then they will expect to continue to receive performance reports showing 1, 3 and 5 year returns, along with returns since inception.

If the use of DWR is mandated, then the CSA is effectively requiring registrants to incur the cost of restating history for all clients in place at the date of implementation of the Proposals. Reporting returns to investors using a mix of methodologies is not acceptable and would create confusion. This implication and the associated costs are not reflected anywhere in the Proposals.

Determining Market Value

The Proposals prescribe the use of bid price to value long positions in securities and ask price for short positions. In our view this is overly prescriptive and is not in accordance with Canadian GAAP, i.e. IFRS, applicable to the majority of registrants.

The Proposals should not attempt to specify a valuation methodology but rather specify that securities should be shown at fair value in accordance with Canadian GAAP. This approach is consistent with the approach taken in other instruments, such as NI 31-103 for financial statements and NI 81-106 (s. 2.6), which was agreed upon after a previous attempt by the CSA to mandate specific accounting principles was rejected after much discussion. In our view the CSA should not be mandating accounting or valuation specifics but rather it should be left to the worldwide professional accounting bodies. Such an approach would also reduce the section to a couple of sentences.

We also believe that the vast majority of current systems capture closing market prices for valuation purposes. A requirement to change to bid/ask would likely

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incur significant costs.

Change in Value

The Proposals currently require that the investment performance report show the change in value of the account for the previous twelve months and on a cumulative basis. The change in value is to be determined using market values for all additions to and withdrawals from the account. The Proposals also require the reporting of the book cost of security positions.

We wish to point out that, contrary to various comments in the Proposals and the sample report in Appendix E, **the change in value does not represent what the investor has <u>earned</u>**. It merely represents the change in value and nothing more. Any reference to ñearningsò based on this formula is incorrect and should be removed. A report could state that the value of the account has increased or decreased, but nothing more.

If the objective is to show what the investor has in fact earned, then withdrawals or transfers from the account must be reflected at book cost. As in our letter of September 2011 we have attached to this letter as Appendix 1 an example showing the difference between the two approaches. This demonstrates that the change in value of an account, as defined, does not equate to earnings. A calculation using withdrawals at book cost is also consistent with the calculation of returns on a time weighted basis.

In our opinion the CSA must be clear in the Proposals on the definition of terms and what is being presented to investors.

Disclosure of Trailing Commissions

We believe that the proposed requirement for an Investment Fund Manager (ñIFMò) to provide the amount of trailing commissions paid with respect to an advisorôs or dealerôs client puts an unfair, and potentially significant, cost burden on IFMôs. The cost of reporting trailing commissions should be borne by the recipient of the commissions.

A dealer or advisor whose client has invested in an investment fund and who receives a trailing commission should have all necessary information to determine the amount of the trailing commission earned on a client basis. An advisor or dealer has the following information:

a) The advisor/dealer receives the trailing commission from the IFM already identified with the representative to which it relates. This is a key

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component of existing dealer compensation systems.

b) The advisor/dealer knows which of the representativeӳ clients are invested in the specific IFMӳ funds and the amount of the investments since they are reporting the investments to the client.

c) The above information would allow the advisor/dealer to calculate the amount of a trailing commission received that is attributable to a specific client.

Given the above we do not believe that it is fair or appropriate to require the IFM to provide such information. Rather the costs associated with this requirement should fall on the advisor or dealer who has the client and the necessary information and is receiving the compensation.

Disclosure of Operating Charges

We appreciate the clarification that third party charges, such as custodian fees, should not be included in operating charges disclosed to the client.

While we have been given to understand that this also applies to charges levied within an investment fund held by an investor, e.g. management fees, this is not as clear to a reader of the Proposals and is still causing confusion for our members.

We ask that that it be made explicit in the Companion Policy that all charges and expenses levied within an investment are not part of operating charges, i.e. that there is no ѬIook-throughҠinto an underlying investment and that operating charges only include charges paid directly by the client.

Conclusion

In summary we have the following key recommendations:

a) The dollar weighted return method should not be mandated as the methodology for performance reporting. Instead a registrant should be able to utilize a generally acceptable method that meets their clientӳ needs. If a single methodology is to be mandated it should be a time weighted rate of return methodology.

b) Specific methodologies for determining the market value of securities should not be mandated by the CSA but should be determined in accordance with Canadian GAAP, consistent with current practice.

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c) Withdrawals from an account should be at book cost when calculating the change in value if this is intended to equate to client earnings.

d) IFMôs should not be required to provide information to advisors and dealers about trailing commissions paid as the advisors and dealers already have the necessary information to determine the amounts.

e) The Companion Policy should explicitly state that operating charges do not include expenses within investments such as funds, i.e. there is no requirement to ñlook-throughò underlying investments and disclose charges.

We appreciate the opportunity to provide the CSA with our views on the Proposals. 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 our comments further.

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ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

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On behalf of AIMA Canada and the Legal & Finance Committee

APPENDIX 1 – Change in Value vs. Earnings

Assume that an investor opens an account on January 1st and the account has the following transactions and growth during the year.

	Change in Value	**Cost**	**Units**	**MV/Unit**	**Cost/Unit**
Jan 1 investment	$1,000	$1,000	100.0	$10.00	$10.00
Apr 30 market growth	$300	$0	0.0	$3.00	$0.00
April 30 account values	**$1,300**	**$1,000**	**100.0**	**$13.00**	**$10.00**
May 1 client requested withdrawal of $200 ($200 @ $13/unit = 15.4 units)	($200)	($154)	(15.4)		
May 1 closing account values	**$1,100**	**$846**	**84.6**	**$13.00**	**$10.00**
Dec 31 market growth	$400	$0	0.0	$4.73	$0.00
Dec 31 account values	**$1,500**	**$846**	**84.6**	**$17.73**	**$10.00**
Performance Reporting Jan 1 - Dec 31	**Withdrawals on MV Basis**	**Withdrawals on Cost Basis**			
Opening balance	$0	$0			
Additions	$1,000	$1,000			
Withdrawal at market value	($200)				
Withdrawal at cost		($154)			
Change in market value	$700				
Earnings		$654			
Ending market value	$1,500	$1,500			

On a Market Value basis the change in market value does not reflect ñearningsò due to the fact that when the investor withdrew $200 a portion of that withdrawal (15.4 units X $3/unit = $46) was a withdrawal of the growth in market value of the account. Following the Market Value approach the change in market value reported to the investor overstates the value added by the manager of the fund, i.e. $700 implies growth in the per unit value of $8.27 ($700 / 84.6 units) versus the actual growth of $7.73 ($654/ 84.6 units = $7.73/unit, i.e. $17.73 ending market value per unit less $10.00 cost per unit). Withdrawals on a cost basis reflect what the client truly earned.

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