



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

Chairman

Gary Ostoich
Tel. (416) 368-0027

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 Burrton
Tel. (416) 453-0111

www.aima-
canada.org

March 12, 2014

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Series Commission of New Brunswick
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

email: jstevenson@osc.gov.on.ca

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

email: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the "Proposal")

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.

Although the Proposal does not currently impact many of our members we are providing our comments given the importance of this initiative and the CSA proposals on modernizing the regulation of investment fund products as outlined

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

in National Instrument 81-104 in March 2013.

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 1,300 corporate members in more than 50 countries, including many leading investment managers, professional advisers and institutional investors. AIMA Canada, established in 2003, now has more than 100 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 fewer 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, Investment Fund Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

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

In the comments below we refer to the Fund Fact Sheet as "FFS".

Summary and Overview

We acknowledge and appreciate the CSA's recognition of the desirability of establishing a standardized risk classification methodology to facilitate investor comparisons of the risk of investing in different mutual funds. The Proposal and its underlying research represent a good first step towards achieving this goal.

However, we do not agree with major aspects of the Proposal. The major items

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

with which we disagree are:

- The requirement to assess risk over a 10 year timeframe. In our view this represents a smoothing of results and does not necessarily reflect the world faced today by fund managers and investors.
- The requirement to use imputed data, when actual returns are not available, to create the 10 year risk profile. This use of hypothetical or simulated data is contrary to published CSA policy. It also violates the professional standards of the CFA Institute, the professional governing body for the majority of Portfolio Managers in Canada. This is especially important given that the CSA material has indicated that less than 25% of funds have a 10 year history.
- The mandated use of a “reference index” as the basis for any missing data in the 10 year history.

These issues are expanded upon below in answer to various questions from the Proposal.

Comments re CSA Questions

Outlined below are specific CSA questions from the Proposal on which AIMA Canada has comments, which serve to expand upon or add to our summary comments above. In formulating our responses we also reviewed the July 1, 2010 guidelines published by the Committee of European Securities Regulators (the “CESR Guideline”) setting out a methodology for the calculation of the synthetic risk and reward indicator (the “SRRI”) applicable to UCITS funds.

Other questions are omitted as we do not have particular comments to add to the CSA review process.

1. *Should the CSA proceed with (i) mandating the Proposed Methodology or (ii) adopting the Proposed Methodology only as guidance for fund managers to identify the mutual fund’s risk level on the prescribed scale in the Fund Facts? Are there other means of achieving the same objective than by mandating the Proposed Methodology, or by adopting it only as guidance? We request feedback from investment fund managers and dealers on what a reasonable transition period would be for this.*

Given the main objective of establishing a consistent risk evaluation methodology for investment funds AIMA Canada can accept that the Proposed Methodology be mandated. However, this must be subject to fund manager discretion, as outlined in our comments re question #3 below. It is important to recognize that in the Proposal, or any variation thereof, there will always be an element of discretion which cannot be eliminated.

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

If the risk rating is not subject to fund manager discretion, as we recommend, then it should only be guidance. In this way the fund manager can better bring into the assessment the various risk factors that are outlined in the simplified prospectus for the fund.

In our view a 2 year transition period should be sufficient for implementation, in recognition of the annual cycle followed by most fund managers in updating FFS's, i.e. by the end of 2 years after the requirement taking effect, all updates will have been completed.

- 2. We seek feedback on whether you agree or disagree with our perspective of the benefits of having a standard methodology, as well as whether you agree or disagree with our perspective on the cost of implementing the Proposed Methodology.*

The Proposal outlines its benefits as being consistency and transparency of disclosure and improved comparability of investment funds. In our opinion these benefits are only partially met. While there is consistency in the sense that volatility is the measure used by all, its determination remains subject to the discretion of the fund manager, e.g. in the selection of the reference index components to determine the 10 year volatility as outlined in the Proposal.

This issue of discretion will exist in any risk rating system that requires a fund manager to determine a risk rating and can never be eliminated. The comments on the FFS in the Risk Rating section should be required to indicate if the risk rating is based solely on the returns of the fund or if a reference index has been utilized. In the latter case the investor should be referred to the simplified prospectus for a discussion of how the risk rating reference index was determined.

Although the Proposal does not impact many of AIMA Canada's members, it appears reasonable that the costs of implementation should not be significant. However, this could change depending on the transition period for implementation (see our comments in #1 above).

- 3. We do not currently propose to allow fund managers discretion to override the quantitative calculation for risk classification purposes. Do you agree with this approach? Should we allow discretion for fund managers to move their risk classification higher only?*

In our view a fund manager should have discretion to override the quantitative calculation in either direction. We suggest that, consistent with

Enhancing understanding, sound practices and industry growth



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

other CSA initiatives, a fund manager be required to follow a “comply or explain” approach. In such a situation, if a fund manager chooses to adjust the risk rating, then the fund manager would be required to include on the FFS the calculated and adjusted risk rating and explain, in simple language, the rationale for the adjustment. In this way the investors sees both the quantitative calculation and the adjusted rating and can make their own judgment as to which is appropriate.

4. *Keeping the criteria outlined in the introduction above in mind, should we consider a different time period than the proposed 10 year period as the basis for risk rating disclosure? Please explain your reasoning and supplement your recommendations with data/analysis wherever possible.*

In AIMA Canada’s view the proposal to mandate a 10 year period is inappropriate for several reasons. In our opinion it is particularly inappropriate when a reference index must be constructed to create a 10 year history (see our comments in #5 below).

- a) In our opinion the use of 10 years as a relatively “stable” period is misleading. It basically provides a smoothing of results and is not representative of the world today and the volatility of markets, nor is it necessarily representative of periods outside of the 1990-2013 analysis referenced. To the best of our knowledge there is no research indicating that 10 years is a better indicator of a market cycle vs. say 5 years or 15 years, other than that the longer period smooth’s results. The risk analysis should reflect the markets as much as possible.
- b) Research on the longevity of fund classes in Canada (as outlined in the material prepared by staff for the consultations in Toronto and Montreal in September 2013), indicates that only 22% of funds had a 10 year history, 50% had a 5 year history and 65% had a 3 year history. By year 10 of the period 1990-2012 almost 40% of funds launched were closed or merged on average. Hence the proposed requirement to use 10 years will require the imputation of a reference index for the majority of funds, with all of the issues that entails (see our comments in #5 below).
- c) In our opinion based on experience, especially given the longevity of funds noted in (b), very few investors stay in funds for 10 years or invest on that basis. Typically they will be looking at a shorter time horizon. So a 10 year view is of questionable relevance.
- d) Requiring the presentation of a 10 year measure of volatility (real or simulated) is contrary to the CFA Institute’s Global Investment Performance Standards (GIPS), which are the global standard for performance reporting and were developed after years of global consultation and input. Since the volatility measure in the Proposal is based on returns the GIPS is relevant. The majority of our members, as

Enhancing understanding, sound practices and industry growth



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

Portfolio Managers who are CFA's (as generally required by regulation), are expected to follow these standards, especially if their firm is claiming compliance with GIPS. GIPS (Presentation and Reporting Requirements Provision 5.A.2) require the presentation, as of each annual period end, of the three year annualized ex-post standard deviation, using monthly returns. Therefore, requiring a risk rating based on a single 10 year measure puts our members in a position of not meeting their professional requirements.

Given the above comments we suggest that rather than selecting one risk category for a fund, the volatility of the fund be presented over time in graph format by showing, for each period, the annualized three year standard deviation. This would be consistent with GIPS requirements, and would also be consistent with the annual presentation of returns in the FFS. In this way an investor would see a consistent presentation of risk and return. It is important to note that this would be only the presentation of actual fund returns (see our comments in #5 below with respect to reference indices and simulated results).

An example of how this might appear is attached as Appendix A.

Overall we recommend shortening the period to 5 years, similar to the CESR Guideline for UCITS funds.

5. *Keeping the criteria outlined in the introduction above in mind, do you agree with the criteria we have proposed for the use of a reference index for funds that do not have sufficient historical performance data? Are there any other factors we should take into account when selecting a reference index? Please supplement your recommendations with data/analysis wherever possible.*

We do not agree with the requirement to impute performance when there is insufficient performance history, assuming the Proposal's 10 year requirement comes into force (see our comments in #4 above with respect to this aspect of the Proposal).

- a) The Proposal requires the imputation of returns from a reference index to fill in the gaps in order to generate a 10 year risk profile. Such a requirement is contrary to every other CSA pronouncement of which we are aware that addresses this issue, particularly CSA Notice 31-325 *Marketing Practices of Portfolio Managers* issued July 2011 (a successor to OSC Staff Notice 33-729 *Marketing Practices of Investment Counsel/Portfolio Managers* issued November 2007). In both Notices the use of hypothetical or simulated performance data, especially for retail

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

- investors, is basically prohibited. Only actual returns are to be presented. It is also noted that under no circumstances are hypothetical and actual returns to be linked, which the Proposal specifically requires. The prohibition on hypothetical data is due to the various risks and inherent limitations in using such data, as outlined in the Notices. Consequently the generation of a 10 year reference index, presenting such returns as if they were achieved by the fund manager and linking them to actual returns, is contrary to established CSA policy.
- b) The generation of a hypothetical or simulated risk profile, utilizing a linkage of theoretical and actual returns, is also prohibited by the CFA Institutes GIPS (Composite Construction Requirements Provision 3.A.3). So similar to our comments in #4 above, requiring Portfolio Manager's to create such data for the FFS would require them to act contrary to the professional requirements of their designation, a designation which the CSA requires.
 - c) The Proposal indicates that in selecting a reference index a fund manager should comply with the following principles:
 - (i) whenever possible, have returns highly correlated to the returns of the fund;
 - (ii) contain a high proportion of the securities represented in the fund's portfolio with similar portfolio allocations;
 - (iii) have a historical systematic risk profile similar to the fund;
 - (iv) share the same style characteristics and reflect the market sectors in which the fund is investing;
 - (v) have security allocations that represent investable position sizes on a pro rata basis to the fund's total assets;
 - (vi) be denominated or converted to the same currency as the fund's reported net asset value (or the currency of the fund's oldest share class); and
 - (vii) have its returns computed on the same basis (e.g., total return, net of withholding taxes, etc.) as the fund's returns.

We submit that conditions (i) to (v) could be difficult to meet. The conditions as outlined basically assume that a fund's investment policy is a mirror of the index. It is our belief that most managers in fact strive to beat an index benchmark by being different than the index. This is how investment management success is achieved. Therefore use of a reference index, chosen based on the principles above, would not be representative of a fund's investment strategy. This could be particularly applicable to AIMA Canada's members, most of who manage hedge funds and employ short sale strategies.

In light of our objections above the following alternatives should be considered:

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



- a) When a fund is new the CSA could remove all discretion and dictate the assignment of the risk category, subject to a “comply or explain” model. As outlined in the material prepared by staff for the consultations in Toronto and Montreal in September 2013, a summary by CIFSC category of current fund risk disclosure and their distribution across risk bands was prepared. The results are fairly consistent by fund category, i.e. the industry overall has a fairly consistent view of the risk attached to a given investment strategy (albeit high level descriptions). A fund manager could be required to assign a risk rating based on such data, published and updated annually by the CSA or IFIC. If a fund manager does not believe that such a categorization is correct, then another category could be assigned. Both would be shown on the FFS, with the fund manager’s explanation in simple language as to why a different rating is considered appropriate. The investor can then decide which viewpoint they want to take when evaluating the investment. This assignment of category would continue for 5 years until actual fund performance data is available.
- b) If the CSA considers that a reference of some kind is required, then the usage of a representative portfolio model or target asset mix to create the simulation, in addition to a benchmark index, should also be allowed. This would be employed for the first 5 years, after which actual fund data would be used. Fund managers would have the same requirements for data retention, explanations in the simplified prospectus etc. They would also be required, on at least an annual basis, to evaluate the simulation against actual fund results. In the event of significant differences the fund manager would be required to determine the reasons for the divergence and restate the risk assessment. We note that allowing the use of models etc. is consistent with the CESR approach.
6. *Do you agree with the proposed process for monitoring risk ratings? Keeping the criteria outlined in the introduction above in mind, would you propose a different set of parameters or different frequency for monitoring risk rating changes? If yes, please explain your reasoning. Please supplement your recommendations with data/analysis wherever possible.*

AIMA Canada does not believe that the proposed risk monitoring process is appropriate, both in consistency and frequency.

The CSA has outlined various reasons for proposing that a 10 year standard deviation be used, mainly that it is felt to be more reflective of market cycles etc. As per the Explanatory Note in Annex A of the Proposal “Over shorter periods we found that risk indicators (including standard deviation)

Enhancing understanding, sound practices and industry growth



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

tended to fluctuate too much. Over shorter time periods, risk indicators also have a tendency to be misleading" (emphasis added). If that is the case, then it is clearly inconsistent to require monitoring of the standard deviation based on the last 12 months and require press releases and changes to a fund's risk rating based on this data. If shorter time periods are inappropriate to determine the initial risk rating, as the CSA concludes, then changes to the risk rating based on one year of returns are clearly inappropriate, absent a major change in a fund's investment policy or strategy (see our recommendation below).

We are in agreement with the comments in the CESR Guideline (page 7) that it is not desirable to develop a risk indicator that could involve frequent changes of category since this might give investors cause for concern over the reliability of the indicator.

Given the above, in our opinion a monthly monitoring process is not required. The requirement to publish a press release and update FFS's potentially imposes an undue workload and costs on the fund manager with many funds and classes, each class of which is required to have a FFS.

Our recommendation is that the monitoring of the risk rating be done on a semi-annual or annual basis. Any changes to a fund's risk rating should be a required discussion point in the fund's Management Report of Fund Performance under NI 81-106 for the period of the change. An evaluation at other than these intervals would only be required if there is a material change in investment policy or strategy.

7. *Is a 10 year record retention period too long? If yes, what period would you suggest instead and why?*

In our opinion there is no reason to impose a retention period on this particular piece of data that is different from other regulatory requirements. National Instrument 31-103 Section 11.5 mandates an overall retention period of 7 years for all business records to "demonstrate the extent of the firm's compliance with applicable requirements of securities legislation." This requirement would include this data by definition. Using this general provision would ensure consistency and ease of implementation for the industry. It is more difficult and creates the risk of problems if one set of business records must be carved out for different treatment. There is no need to specify a retention period at all in the Proposal as the general requirements would apply.

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

Conclusion

In summary we agree with the CSA's objective of establishing a standardized risk classification methodology to facilitate investor comparisons of the risk of investing in different mutual funds. However we disagree with major aspects of the Proposal and recommend the following modifications for consideration:

1. A clear acknowledgment in the ultimate regulation that any risk assignment includes discretion and reflects the judgment of the fund manager.
2. Risk should be assessed over a timeframe of 5 years, which we consider more relevant to investor time horizons and the current market.
3. Imputed or hypothetical data should not be used to create the risk profile in the absence of actual fund results. At the inception of a new fund the overall general investment industry classification of funds in the strategy category should be assigned, unless the manager can demonstrate a material difference warranting a different risk rating. Both ratings would be indicated on the FFS for an investor to consider. If the CSA does not accept this proposal, then fund managers should also be able to determine a risk rating using model or target portfolios, in addition to a reference index.
4. After 5 years the risk rating would be determined based on the actual experience of the fund. The actual experience would be shown on the FFS in graphical form as a trend line, rather than using a single rating.
5. Risk ratings should be reviewed and reassessed annually, unless there is a change in the fund's investment objective or strategy in the interim.

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

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

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

Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

Ian Pember

On behalf of AIMA Canada and the Legal & Finance Committee

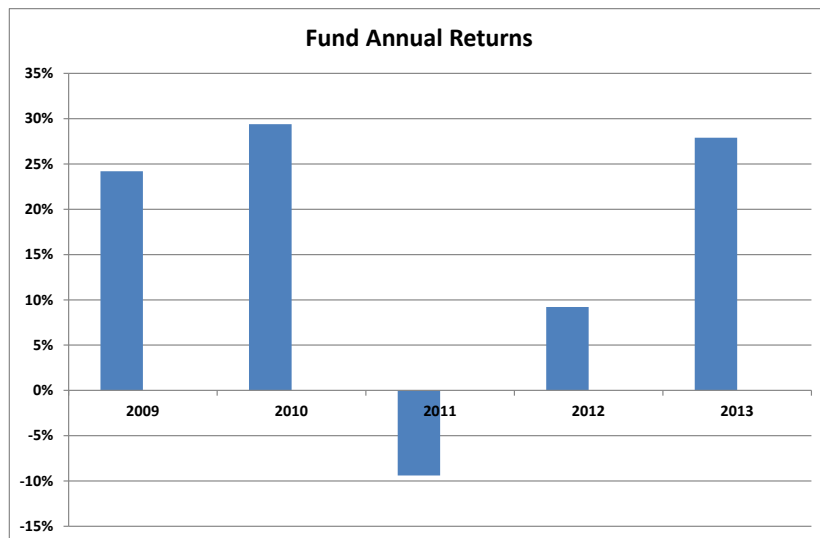
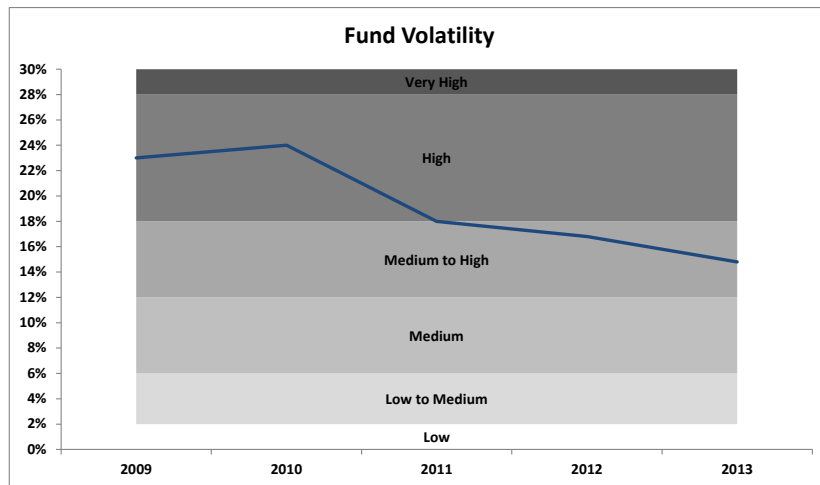
Enhancing understanding, sound practices and industry growth

The Alternative Investment Management Association - Canada
80 Richmond Street West, Suite 504, Toronto, ON, M5H 2A4
Tel. 416-453-0111 Email: info@aima-canada.org Internet: www.aima-canada.org



APPENDIX A - Alternative Presentation of Fund Risk

AIMA Canada's suggestion is to present a trend line of fund volatility, rather than picking one measure at a point in time. Below is an example of how such a graph might look, along with a corresponding graph showing annual returns, as the FFS requires. The periods for both graphs would be required to be consistent.



Enhancing understanding, sound practices and industry growth