Canada

Regulation

HEDGE FUNDS 2010

Hedge fund managers/advisors

Regulation

The regulatory framework falls under the jurisdiction of each of the provinces and territories of Canada and there is currently no established national framework. There are 10 provinces and three territories. The largest authority is the Ontario Securities Commission but its authority is confined to the province of Ontario. Collectively, the provincial and territorial regulators are referred to as the Canadian Securities Administrators.

Although the legislation varies between provinces, national policies, or multi-lateral policies have been established which are applied in all or some provinces and territories. The majority of the regulations relate to public mutual funds, but many also apply to private (hedge) funds, which are the focus of this publication. The regulatory discussions below will focus on the province of Ontario, unless otherwise noted, as it is the most significant jurisdiction of registration for hedge funds and managers in Canada.

Currently, several types of registration are required for a hedge fund manager. As an entity providing investment advice, registration as an advisor is required. As an entity selling securities (in a hedge fund), registration as a dealer is required. Generally, advisor registration is only required in the province or territory in which the fund is formed whereas dealer registration is required in all jurisdictions in which the fund is sold.

Authorization requirements and process

New or revised registration requirements were introduced in most Provinces and Territories on 28 September 2009. The new or revised rules introduced new registration categories as well as additional capital, proficiency, insurance, and other requirements. The aim of the Registration Reform Rules was to nationally harmonize and streamline registration regimes across the provinces and territories.

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As an advisor, a hedge fund manager is typically registered as portfolio manager, as a dealer is typically registered as an exempt market dealer (EMD), and as a manager of a fund is typically registered as an investment fund manager. Each of these registrations is subject to insurance, capital, proficiency and other requirements.

Once registered, a hedge fund manager has ongoing reporting requirements, such as those related to reporting the sale of units of the fund. A manager must comply with general securities law relating to such things as insider trading, conflicts of interest, proxy voting, etc., and must also comply with federal and/or provincial information privacy, anti-terrorist and anti-money laundering rules. A registrant must also have written policies and procedures to ensure compliance with all applicable regulatory requirements. A registrant is required to file annual audited financial statements with the regulators and in some case quarterly and other reporting.

In order to register in a jurisdiction, a hedge fund manager will need to follow the process for initial registration in that jurisdiction. This process will vary by jurisdiction and by registration category but typically requires proof of proficiency and insurance, audited financial statements, and payment of registration fees, among other requirements.

Typical timescale to receive approval

It takes approximately one to two months to create a management company in Canada and the costs, including professional fees, etc., are likely to amount to approximately CAD 50,000.

Regulatory capital requirements

In Ontario, the minimum capital requirements are CAD 25,000 for a portfolio manager, CAD 50,000 for an exempt market dealer and CAD 100,000 for an investment fund manager. These capital requirements are not cumulative for multiple registrations.

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Hedge fund structures

Regulation

Hedge funds in Canada are typically formed as trusts or limited partnerships, and less frequently as corporations. Tax considerations are the most significant factor when choosing a legal structure. For example, a trust may be able to qualify as a registered investment and accept subscriptions from retirement plans whereas a partnership can not. However, a partnership is able to flow through losses to an investor whereas a trust can not. Refer to the Taxation section of this publication for a more complete discussion of the taxation of hedge funds in Canada.

The regulation of hedge funds varies by province or territory. However, the National Exemption Rule generally allows for the distribution of hedge fund interests in any jurisdiction under certain exemptions.

Authorization requirements

Typically, hedge funds are not treated as reporting issuer mutual funds and are able to distribute their securities without a prospectus in most jurisdictions of Canada under a variety of exemptions. The exemptions vary by province or territory and are discussed in further detail below.

There are generally no requirements to provide an offering memorandum to investors (unless the fund is being offered under offering memorandum exemption). Where an offering memorandum is provided, there are typically no regulatory requirements as to its contents, however, there may be required disclosures related to statutory investor protection rights depending on the jurisdiction. If an offering memorandum is provided in relation to the sale of hedge fund securities it will typically need to be filed with the appropriate securities regulator.

Restrictions on types of investments, concentration levels, and the manner in which hedge funds can invest and/or strategies

There are no regulatory restrictions on the investments that can be made by a hedge fund. Typically, a hedge fund will include investment restrictions in its offering document.

Rules regarding the publishing of the accounts and prospectuses

National Instrument 81-106 (NI 81-106) contains the continuous disclosure requirements for investment funds in most jurisdictions of Canada, including all public and most private funds. The requirements include the following for private funds:

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- Annual audited financial statements must be provided to investors and securities regulators within 90 days of year-end (although an exemption from filing with the regulators is typically obtained).

- Semi-annual un-audited financial statements must be provided to investors and regulators within 60 days of the interim period-end (although an exemption from filing with the regulators is typically obtained).

- Financial statements must be prepared in accordance with Canadian GAAP and NI 81-106 imposes additional disclosure requirements, such as the inclusion of a Statement of Investment Portfolio.

Time-scale of establishment of a hedge fund

It takes approximately one month on average to create a fund in Canada and the costs, including professional fees, etc., are likely to amount to approximately CAD 25,000.

Investors

Regulation

Restrictions on which type of investors can invest in a hedge fund and/or the minimum/maximum number of investors in a hedge fund

The conditions under which securities in hedge funds may be sold to investors varies by province or territory. Typically, distribution of hedge fund securities takes place in the exempt market and the typical exemptions include:

- accredited investor exemption: government agencies, institutions, high net worth individuals, etc.;

- minimum purchase exemption: aggregate purchase price of CAD150,000; and

- offering memorandum exemption - offering memorandum with prescribed disclosures provided to investors (not available in Ontario).

There is no limit on the number of investors in a hedge fund; however, the tax treatment of a fund may be affected by inadequate public distribution as it may then fail to qualify as either a mutual fund trust or a mutual fund corporation.

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