

## **Headnote**

National Policy 11-203 *Process for Exemptive Relief Applications in Multiple Jurisdictions* – Alternative mutual funds granted relief from section 2.9.1 of National Instrument 81-102 *Investment Funds* to permit the use of Value at Risk (VaR) to calculate exposure – VaR limited to 20% of NAV – Relief granted from section 2.1 of National Instrument 81-101 *Mutual Fund Prospectus Disclosure* for the purposes of relief requested from Item 3 of Part I of Form 81-101F3 *Contents of Fund Facts Document* and Item 4 of Part B of Form 81-101F1 *Contents of Simplified Prospectus* to exempt the mutual fund from the requirement to disclose its maximum aggregate exposure to leverage as calculated pursuant to Section 2.9.1 of NI 81-102 – Relief subject to conditions including the establishment of a derivatives risk management program and use of third-party verification of VaR calculations.

Relief granted from 15.3(2), 15.3(4)(c), 15.6(1)(a)(i), 15.6(1)(d), 15.8(2)(a.1), and 15.8(3)(a.1) of NI 81-102 to permit an alternative mutual fund, that has not distributed securities under a simplified prospectus in a jurisdiction for 12 consecutive months, to include in their sales communications performance data for the period when the fund was not a reporting issuer – Relief granted from section 15.1.1 of NI 81-102 to permit a mutual fund to use performance data from periods prior the fund being a reporting issuer in calculating fund’s investment risk level in accordance with Appendix F *Investment Risk Classification Methodology* to NI 81-102 and to disclose the risk level in the fund facts and ETF Facts – Relief granted from section 2.1 of National Instrument 81-101 *Mutual Fund Prospectus Disclosure* for the purposes of relief requested from (i) Item 4 and 5 of Part I of Form 81-101F3 *Contents of Fund Facts Document*, to permit the mutual fund to disclose in its fund facts the risk level calculated in accordance with the relief granted from NI 81-102 and to include in its fund facts the past performance data for the periods when the fund was not a reporting issuer, and (ii) Item 10(b) of Part B of Form 81-101F1 *Contents of Simplified Prospectus* to permit the mutual fund to disclose the risk level methodology used in accordance with relief from NI 81-102 – Relief subject to conditions.

Relief granted from section 4.4 of National Instrument 81-106 *Investment Fund Continuous Disclosure* for the purposes of the relief requested from Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*, Items 3.1(7), 4.1(1), 4.1(2), 4.2(1), 4.3(1) and 4.3(2) of Part B of Form 81-106F1, and Items 3(1) and 4 of Part C of Form 81-106F1, to permit a mutual fund to include in annual and interim management reports of fund performance the financial highlights and past performance of the fund that are derived from the fund’s annual financial statements that pertain to time periods when the fund was not a reporting issuer – Relief subject to conditions.

## **Applicable Legislative Provisions**

National Instrument 81-102 *Investment Funds*, section 2.9.1, subsection 15.3(2), paragraph 15.3(4)(c), subparagraph 15.6(1)(a)(i), paragraphs 15.6(1)(d), 15.8(2)(a.1) and 15.8(3)(a.1), and sections 15.1.1 and 19.1.

National Instrument 81-101 *Investment Fund Prospectus Disclosure*, sections 2.1 and 6.1.

Items 4 and 10(b) of Part B of Form 81-101F1 *Contents of Simplified Prospectus*.

Item 3, 4 and 5 of Part I of Form 81-101F3 *Contents of Fund Facts Document*.

National Instrument 81-106 *Investment Fund Continuous Disclosure*, sections 4.4 and 17.1.

Items 3.1(7), 4.1(1), 4.1(2), 4.2(1), 4.3(1) and 4.3(2) of Part B and Items 3(1) and 4 of Part C of Form 81-0106F1 *Contents of Annual and Interim Management Report of Fund Performance*.

**Citation: Re Auspice Capital Advisors Ltd., 2023 ABASC 25**

**Date: 20230223**

In the Matter of  
the Securities Legislation of  
Alberta and Ontario (the **Jurisdictions**)

and

In the Matter of  
the Process for Exemptive Relief Applications in Multiple Jurisdictions

and

In the Matter of  
Auspice Capital Advisors Ltd. (the **Filer**)

### **Decision**

#### **Background**

The securities regulatory authority or regulator in each of the Jurisdictions (each a **Decision Maker**) has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the **Legislation**) to grant the Filer, Auspice Diversified Trust (**ADT**) and Auspice One Fund Trust (**AOFT**, and together with ADT, the **Funds** and individually, a **Fund**) exemptive relief from

#### *Leverage*

- (a) the requirements of
  - (i) Section 2.9.1 of National Instrument 81-102 *Investment Funds (NI 81-102)*, which limits an alternative mutual fund's aggregate exposure to cash borrowing, short selling and specified derivatives transactions to 300% of the fund's net asset value;
  - (ii) Item 4 and instruction (4) of Part B of Form 81-101F1 *Contents of Simplified Prospectus (Form 81-101F1)* and item 3 of Part I of Form 81-101F3 *Contents of Fund Facts Document (Form 81-101F3)*, which all require an alternative mutual fund to disclose its maximum aggregate exposure to leverage as calculated pursuant to Section 2.9.1 of NI 81-102

(collectively, the **Leverage Relief**); and

*Performance*

- (b) the requirements of
  - (i) Subsection 15.3(2), paragraph 15.3(4)(c), subparagraph 15.6(1)(a)(i), and paragraphs 15.6(1)(d), 15.8(2)(a.1) and 15.8(3)(a.1) of NI 81-102, to permit each Fund to include its past performance data in sales communications notwithstanding that the past performance data will relate to a period prior to that Fund offering its units under a simplified prospectus, including with respect to the Auspice One Fund LP (**AOF LP**) as pertains to AOFT (the **past performance data**);
  - (ii) Paragraph 15.1.1(a) of NI 81-102 and items 2 and 4 of Appendix F *Investment Risk Classification Methodology* to NI 81-102 (the **Risk Classification Methodology**) to permit each Fund to include its past performance data in determining its investment risk level in accordance with the Risk Classification Methodology;
  - (iii) Paragraph 15.1.1(b) of NI 81-102, and item 4(2)(a) and instruction (1) of item 4 of Form 81-101F3, to permit each Fund to disclose its investment risk level as determined by including its past performance data in accordance with the Risk Classification Methodology;
  - (iv) Item 10(b) of Part B of Form 81-101F1, to permit each Fund to use its past performance data to calculate its investment risk rating in its simplified prospectus;
  - (v) Items 5(2), 5(3) and 5(4) and instruction (1) of Part I of Form 81-101F3 in respect of the requirement to comply with subsection 15.3(2), paragraph 15.3(4)(c), subparagraph 15.6(1)(a)(i), and paragraphs 15.6(1)(d), 15.8(2)(a.1) and 15.8(3)(a.1) of NI 81-102, to permit each Fund to include in its fund facts document the past performance data of that Fund notwithstanding that such performance data relates to a period prior to that Fund offering its units under a simplified prospectus, including with respect to AOF LP as pertains to AOFT, and that such Fund has not distributed its units under a simplified prospectus for 12 consecutive months;
  - (vi) Section 2.1 of National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**NI 81-101**) for the purposes of the relief requested from Form 81-101F1 and Form 81-101F3;
  - (vii) Items 3.1(7), 4.1(1) (in respect of the requirement to comply with subsection 15.3(2)) and paragraph 15.3(4)(c) of NI 81-102, items 4.1(2), 4.2(1), 4.3(1) and 4.3(2) of Part B of Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* (**Form 81-106F1**), and items 3(1) and 4 of Part C of Form 81-106F1 to permit each Fund to include in its annual and interim management reports of fund performance (**MRFP**) the past performance data and financial highlights of that Fund notwithstanding

that such performance data and financial highlights relate to a period prior to that Fund offering its units under a simplified prospectus, including with respect to AOF LP as pertains to AOFT; and

- (viii) Section 4.4 of National Instrument 81-106 *Investment Fund Continuous Disclosure* (**NI 81-106**) for the purposes of relief requested herein from Form 81-106F1;

(collectively, the **Performance Relief** and together with the Leverage Relief, the **Exemption Sought**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a dual application),

- (a) the Alberta Securities Commission is the principal regulator for this application (the **Principal Regulator**);
- (b) the Filer has provided notice that subsection 4.7(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon in each jurisdiction of Canada, other than Alberta and Ontario; and
- (c) the decision is the decision of the Principal Regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

### **Interpretation**

Terms defined in National Instrument 14-101 *Definitions*, MI 11-102 and NI 81-101 have the same meaning if used in this decision, unless otherwise defined.

### **Representations**

This decision is based on the following facts represented by the Filer:

The Filer, ADT, AOF LP and AOFT

1. The Filer is registered as a portfolio manager, investment fund manager and exempt market dealer in Alberta, as a commodity trading manager, investment fund manager and exempt market dealer in Ontario, as an investment fund manager in British Columbia, Québec, and Newfoundland and Labrador, and as an exempt market dealer in British Columbia and Québec. The Filer's head office is in Calgary, Alberta.
2. The Filer initially launched the Managed Futures LP (the **Partnership**) in 2006. Units of the Partnership were offered by means of an offering memorandum to qualified Canadian investors on a private placement basis.
3. The investment objective of the Partnership was to generate returns on investments in exchange traded futures, options, forward contracts for commodities, financial instruments and currencies, including physical commodities, and exchange traded funds (**Commodity Interests**) that generate returns that are independent of equity, fixed income and real estate investments.

4. In June 2009, the Filer launched ADT as a pooled fund. Units of ADT are offered by means of an offering memorandum to qualified Canadian investors on a private placement basis.
5. Initially, ADT invested substantially all of its assets in units of the Partnership.
6. The Partnership was dissolved on June 10, 2020, and ADT now invests directly in Commodity Interests. The investment objective of ADT is now the same as the investment objective of the Partnership prior to its dissolution.
7. ADT is a trust governed by the laws of Alberta.
8. The Filer established AOF LP in August 2020. Units of AOF LP were offered by means of an offering memorandum to qualified Canadian investors on a private placement basis.
9. The investment objective of AOF LP was to achieve superior absolute and risk-adjusted returns as compared to balanced funds or long-equity funds, with the added benefits of protection and performance during sustained downward trends.
10. AOF LP was a limited partnership governed by the laws of Alberta. AOF LP was dissolved on December 31, 2022.
11. In June 2021, the Filer launched AOFT. Units of AOFT are offered by means of an offering memorandum to qualified Canadian investors, including registered retirement savings plans and other similar retirement vehicles, on a private placement basis. AOFT was created to give registered plans and other smaller investors access to the investment strategies of AOF LP.
12. The investment objective of AOFT is the same as the investment objective of AOF LP.
13. Until December 31, 2022, AOFT invested substantially all of its assets in units of AOF LP. AOFT now directly implements the same investment strategies that AOF LP did, and directly invests in the same securities and derivatives that AOF LP did prior to its dissolution.
14. AOFT is a trust that is governed by the laws of Alberta.
15. The Filer and the Funds are not in default of securities legislation in any jurisdiction of Canada.

#### *Alternative Mutual Funds*

16. The Filer wishes to offer units of ADT and AOFT to interested retail investors by means of a simplified prospectus and fund facts document as alternative mutual funds that comply with the requirements of NI 81-102 and all other applicable securities legislation, including NI 81-101, National Instrument 81-105 *Mutual Fund Sales Practices*, NI 81-106 and National Instrument 81-107 *Independent Review Committee for Investment Funds*.
17. Except for the Exemption Sought, each Fund will comply with the requirements for alternative mutual funds in NI 81-102.

*Leverage*

18. The Filer's diversified program is a rules-based, unconstrained (e.g., ADT and AOFT are not constrained from participating in opportunities, long and short, in a variety of asset classes), systematic multi-strategy investment program that is designed to deliver superior, non-correlated returns at critical times.
19. The Filer uses a combination of short selling and specified derivatives that at times results in ADT's and AOFT's aggregate exposure to cash borrowing, short selling and specified derivatives transactions exceeding 300% of the applicable Fund's net asset value, but in a manner that does not expose either Fund to an inappropriate level of leverage risk.
20. The correlations of most alternative investment strategies to equity benchmarks such as the S&P 500 are high. In contrast, most managed futures strategies that are used by commodity trading advisors (each a CTA) like the Filer are historically uncorrelated and risk reducing.
21. Furthermore, notional exposures of futures contracts move with price and do not represent risk. Risk, as measured by futures exchanges, is a function of price and volatility, both of which are captured in value-at-risk (**VaR**) (as defined in Appendix A), but not notional exposure. As noted below, VaR is a better measure of risk for the Funds.
22. For example, the total aggregate exposure of each Fund as calculated pursuant to section 2.9.1 of NI 81-102 is typically between 150% and 500%, and has averaged 285% since inception for ADT. Notwithstanding this range, risk is still managed by the Filer at a consistent level, and there is no relationship between aggregate notional exposure and the volatility of returns that the Filer has delivered for 16 years. The Filer targets and manages to a 10% to 12% volatility level, and in order to do so, aggregate notional exposure varies significantly. Historically, periods of higher than average aggregate notional exposure have not represented periods of higher volatility (or risk), and periods of lower than average aggregate notional exposure have not represented periods of lower volatility (or risk).
23. The Filer on behalf of each Fund has used multiple definitions of risk to capture uncorrelated returns while remaining adaptable to changing market conditions. The Filer also systematically manages risk across multiple constraints at the sector and the market level.
24. The current regulatory framework in Section 2.9.1 of NI 81-102 does not appropriately or adequately address the uniqueness of the investment strategies that CTAs like the Filer employ.
25. The key differences between what the Filer and other CTAs do versus other typical portfolio managers is they
  - (a) trade futures on margin, which is different than stocks and bonds (e.g., for stocks and bonds exchange margin requirements are determined by the value of the securities, whereas for futures, exchange margin requirements are determined by notional exposure and volatility (the primary inputs to VaR models));
  - (b) are systematic and technical versus being fundamental and discretionary;

- (c) utilize systematic risk management, capital allocation and drawdown management techniques; and
  - (d) provide returns that have historically reduced overall profit risk versus risk replacement or adding additional risk.
- 26. The European Union approved a new regulation of mutual funds in 2010 in the fourth European Directive covering Undertakings for Collective Investment in Transferable Securities (**UCITS IV**), which introduced a VaR based approach to regulatory risk management for investment funds that extensively use derivatives.
- 27. This approach allows for two methods of VaR limits, “relative” and “absolute”, as defined in Appendix A, and which in general terms can be summarized as follows:
  - (a) Relative: This approach uses a ratio of up to 200% between the VaR of the portfolio and the VaR of a reference portfolio.
  - (b) Absolute: This approach is generally used when there is no reference portfolio or benchmark and allows the one-month VaR to be up to 20% of the net asset value of the portfolio.
- 28. UCITS IV also includes rules for the computation of VaR and requires regular stress- and back-testing to complement the VaR estimation.
- 29. On October 28, 2020 the U.S. Securities and Exchange Commission adopted new Rule 18f-4 under the *Investment Company Act of 1940* (17 CFR § 270.18f-4, the **SEC Rule**), which modernized the regulatory framework for derivatives use by registered funds. The SEC Rule is generally the same as the UCITS IV rule as it adopted a 200% limit for funds using a relative VaR approach, and a 20% VaR limit for funds using an absolute VaR approach.
- 30. When dealing with a fund that is managed using a multi-asset approach like the Filer and other CTAs do, a VaR-based approach is a better means of managing risk because, unlike notional amounts which do not measure risk or volatility, VaR enables risk to be measured in a reasonably comparable and consistent manner.
- 31. The risk-based approach in the SEC Rule, which relies on VaR, stress testing, and overall risk management, addresses concerns about fund leverage for investment portfolios managed by CTAs like the Filer, while allowing such portfolios to continue to use derivatives for a variety of purposes.
- 32. The Filer has employed VaR-based risk management for its funds, including each of the Funds, for several years that are consistent with both the SEC Rule and the UCITS IV rules. Since the Filer’s inception, it has been using volatility-based risk measures as its primary risk metric.
- 33. ADT and AOFT should be managed on the basis that they comply with VaR limits that do not exceed 20% of the net asset value of ADT or AOFT at any time.

34. Allowing the Filer's funds as public funds to use an absolute VaR methodology is the better risk mandate that CTAs like the Filer use and should give investors access to an investment product that will diversify their holdings and may result in superior non-correlated returns at critical times. Of the two VaR approaches ("absolute" and "relative") used in the UCITS IV rules and the SEC Rule, the absolute approach is the approach that is most suitable for CTAs as there typically is no reference portfolio that would be appropriate for a CTA strategy.
35. With minor exceptions, both ADT and AOFT have consistently operated well below a 20% absolute VaR limit.
36. The Filer already uses a VaR model and has the necessary policies and procedures in place, and, when they are public funds, each Fund will adhere to a 20% absolute VaR limit and operate in accordance with the conditions set out in Appendix A, which are based on the SEC Rule.
37. The Filer will use a historical simulation VaR model with respect to each of the Funds, when they are public funds, that will not change. In addition, the Filer will upload the investment portfolios of ADT and AOFT each business day to the Bloomberg MARS system in order to have the daily reports from the Bloomberg MARS system (each a **Bloomberg Report**) confirm that each of ADT and AOFT is compliant with the applicable VaR test as set out in Appendix A on each business day.
38. The Filer has appointed a "derivatives risk manager" (a **DRM**) and has developed a "Derivatives Risk Management Program" (the **DRMP**) that is consistent with and adheres to the conditions set out in Appendix A, which are based on the SEC Rule. A copy of the DRMP has been provided to the Principal Regulator.
39. The Filer's DRMP incorporates the well documented policies and procedures for risk monitoring, risk management, and risk reporting of a fund's VaR methodology to regulators as developed by securities regulators in the U.S. and the EU.

#### *Performance*

40. Since the commencement of operations of each Fund, the units of that Fund, including with respect to AOF LP as pertains to AOFT, have been distributed to investors on a prospectus-exempt basis in accordance with National Instrument 45-106 *Prospectus Exemptions* in each jurisdiction of Canada.
41. Each Fund will distribute its units pursuant to a simplified prospectus and fund facts document (the **Disclosure Documents**). Upon the issuance of a final receipt for the Disclosure Documents of each Fund, that Fund will become a reporting issuer in each jurisdiction of Canada and, except for the Exemption Sought, will become subject to the requirements of NI 81-102 that relate to alternative mutual funds and the requirements of NI 81-106 that apply to investment funds that are reporting issuers.



42. Each Fund will be managed on the same basis after it becomes a reporting issuer as it was during the period before it became a reporting issuer. The investment objective, fees and day-to-day administration will not change when a Fund becomes a reporting issuer.
43. Except as set out herein, each Fund has complied with the investment restrictions and practices contained in NI 81-102 since inception.
44. The Filer proposes to use each Fund's past performance data to determine its investment risk level and to disclose that investment risk level in the Disclosure Documents for each class of units of that Fund. Without the Performance Relief, the Filer, in determining and disclosing each Fund's investment risk level in the Disclosure Documents for each class of units of that Fund, cannot use performance data of that Fund that relates to a period prior to that Fund becoming a reporting issuer, including with respect to AOF LP in relation to AOFT.
45. The Filer proposes to include in the fund facts documents for each class of units of each Fund past performance data in the charts required by items 5(2), 5(3) and 5(4) of Form 81-101F3 under the sub-headings "Year-by-year returns", "Best and worst 3-month returns" and "Average return", respectively, related to periods prior to that Fund becoming a reporting issuer in each jurisdiction of Canada. Without the Exemption Sought, the fund facts documents of each Fund cannot include performance data of that Fund that relates to a period prior to that Fund becoming a reporting issuer, including with respect to AOF LP in relation to AOFT.
46. As a reporting issuer, each Fund is required under NI 81-106 to prepare and send MRFPs to all holders of its securities on an annual and interim basis. Without the Exemption Sought, the MRFPs of each Fund cannot include financial highlights and performance data of that Fund that relates to a period prior to that Fund becoming a reporting issuer, including with respect to AOF LP in relation to AOFT.
47. The performance data and other financial data of each Fund for the time period before it became a reporting issuer is significant and meaningful information for existing and prospective investors of units of that Fund.

### **Decision**

Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Makers to make the decision.

### *Leverage Relief*

1. The decision of the Decision Makers under the Legislation is that the Leverage Relief is granted, provided that
  - (a) the Filer has appointed a DRM;
  - (b) the Filer and each Fund complies with the absolute VaR test, as defined in Appendix A, and complies with all of the additional leverage conditions for funds set out in Appendix A;

- (c) the Filer discloses in the Disclosure Documents the maximum VaR that each Fund is permitted to incur, and the Filer discloses in the annual and interim MRFP of each Fund the maximum amount of VaR incurred by each Fund over the applicable period;
- (d) the Filer files a copy of its initial DRMP with the Principal Regulator;
- (e) the Filer notifies the Principal Regulator promptly of any changes to its DRM or DRMP;
- (f) no later than 30 days after the end of each month, the Filer prepares and retains a monthly portfolio investment report containing the elements set out in its DRMP, and, no later than 60 days after the end of each fiscal quarter, files with the Principal Regulator the monthly portfolio investment reports for that quarter;
- (g) the Filer does not change the VaR model that it is using with respect to each Fund.
- (h) the Filer uploads the investment portfolios of ADT and AOFT each business day to the Bloomberg MARS system in order to have the applicable Bloomberg Reports confirm that each of ADT and AOFT is compliant with the applicable VaR test as set out in Appendix A on each business day;
- (i) the Filer provides to the Principal Regulator on a quarterly basis a copy of each daily Bloomberg Report for the last quarter for both ADT and AOFT;
- (j) the Filer notifies the Principal Regulator within one business day if either ADT or AOFT is offside the 20% VaR test for more than five consecutive business days, providing the information set out in the Auspice VaR Breach Memo, as defined in the DRMP;
- (k) the Filer promptly (e.g., within 24 hours) provides the Principal Regulator with any other information that the Principal Regulator may request regarding the inter-month calculations and risk metrics the Filer is using; and
- (l) the Filer appropriately documents its risk methodology for ADT and AOFT in accordance with the requirements of the Risk Classification Methodology.

### *Performance Relief*

- 2. The decision of the Decision Makers under the Legislation is that the Performance Relief is granted, provided that
  - (a) any sales communication, fund facts documents and MRFP that contains performance data of the units of a Fund relating to a period of time prior to when the Fund was a reporting issuer discloses that
    - (i) the Fund was not a reporting issuer during such period;

- (ii) the expenses of the Fund would have been higher during such period had the Fund been subject to the additional regulatory requirements applicable to a reporting issuer;
  - (iii) the Filer obtained exemptive relief on behalf of the Fund to permit the disclosure of performance data of the units of the Fund relating to a period prior to when the Fund was a reporting issuer, including with respect to AOF LP in relation to AOFT; and
  - (iv) with respect to any MRFP, the financial statements of the Fund for such period are posted on the Filer's website and are available to investors upon request; and
- (b) the Filer posts the financial statements of each Fund on the Filer's designated website and delivers those financial statements to investors upon request.

*Expiration*

3. This decision expires on February 22, 2027.

*"original signed by"* \_\_\_\_\_

Denise Weeres  
Director, Corporate Finance  
Alberta Securities Commission

## APPENDIX A

### ADDITIONAL LEVERAGE CONDITIONS

In these conditions,

“absolute VaR test” means that the VaR of a fund’s portfolio does not exceed 20% of the value of the fund’s net assets;

“board”, with respect to a fund, means the fund manager’s board of directors;

“derivatives risk manager” means an officer or officers of the fund’s investment adviser responsible for administering the program and policies and procedures required by condition 1 below, provided that the derivatives risk manager:

- (1) may not be a portfolio manager of the fund, or if multiple officers serve as derivatives risk manager, a majority of the derivatives risk managers must not be portfolio managers of the fund; and
- (2) must have relevant experience regarding the management of derivatives risk;

“derivatives risks” means the risks associated with a fund’s derivatives transactions or its use of derivatives transactions, including leverage, market, counterparty, liquidity, operational, and legal risks and any other risks the derivatives risk manager deems material;

“derivatives transaction” means

- (1) any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument, under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payment or otherwise; and
- (2) any short sale borrowing.

“designated index” means an unleveraged index that is approved by the derivatives risk manager for purposes of the relative VaR test and that reflects the markets or asset classes in which the fund invests and is not administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used. In the case of a blended index, none of the indexes that compose the blended index may be administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used;

“designated reference portfolio” means a designated index or the fund’s securities portfolio. Notwithstanding the first sentence of the definition of designated index in these conditions, if the fund’s investment objective is to track the performance (including a leverage multiple or inverse multiple) of an unleveraged index, the fund must use that index as its designated reference portfolio;

“independent director” means a director who would be independent within the meaning of section 1.4 of National Instrument 52-110 *Audit Committees*;

“relative VaR test” means that the VaR of the fund’s portfolio does not exceed 200% of the VaR of the designated reference portfolio;

“securities portfolio” means the fund’s portfolio of securities and other investments, excluding any derivatives transactions, that is approved by the derivatives risk manager for purposes of the relative VaR test, provided that the fund’s securities portfolio reflects the markets or asset classes in which the fund invests (i.e., the markets or asset classes in which the fund invests directly through securities and other investments and indirectly through derivatives transactions);

“value-at-risk” or “VaR” means an estimate of potential losses on an instrument or portfolio, expressed as a percentage of the value of the portfolio’s assets (or net assets when computing a fund’s VaR), over a specified time horizon and at a given confidence level, provided that any VaR model used by a fund for purposes of determining the fund’s compliance with the relative VaR test or the absolute VaR test must:

- (1) take into account and incorporate all significant, identifiable market risk factors associated with a fund’s investments, including, as applicable:
  - (i) equity price risk, interest rate risk, credit spread risk, foreign currency risk and commodity price risk;
  - (ii) material risks arising from the nonlinear price characteristics of a fund’s investments, including options and positions with embedded optionality; and
  - (iii) the sensitivity of the market value of the fund’s investments to changes in volatility;
- (2) use a 99% confidence level and a time horizon of 20 trading days; and
- (3) be based on at least three years of historical market data.

## Conditions

1. ***Derivatives risk management program.*** The fund must adopt and implement a written derivatives risk management program (**program**), which must include policies and procedures that are reasonably designed to manage the fund’s derivatives risks and to reasonably segregate the functions associated with the program from the portfolio management of the fund. The program must include the following elements:
  - i. ***Risk identification and assessment.*** The program must provide for the identification and assessment of the fund’s derivatives risks. This assessment must take into account the fund’s derivatives transactions and other investments.
  - ii. ***Risk guidelines.*** The program must provide for the establishment, maintenance, and enforcement of investment, risk management, or related guidelines that provide for quantitative or otherwise measurable criteria, metrics, or thresholds of the fund’s derivatives risks. These guidelines must specify levels of the given criterion, metric, or threshold that the fund does not normally expect to exceed, and measures to be taken if they are exceeded.
  - iii. ***Stress testing.*** The program must provide for stress testing to evaluate potential losses to the fund’s portfolio in response to extreme but plausible market changes or changes in market risk factors that would have a significant adverse effect on the fund’s portfolio,

taking into account correlations of market risk factors and resulting payments to derivatives counterparties. The frequency with which the stress testing under this paragraph is conducted must take into account the fund's strategy and investments and current market conditions, provided that these stress tests must be conducted no less frequently than weekly.

- iv. **Backtesting.** The program must provide for backtesting to be conducted no less frequently than weekly, of the results of the VaR calculation model used by the fund in connection with the relative VaR test or the absolute VaR test by comparing the fund's gain or loss that occurred on each business day during the backtesting period with the corresponding VaR calculation for that day, estimated over a one-trading day time horizon, and identifying as an exception any instance in which the fund experiences a loss exceeding the corresponding VaR calculation's estimated loss.
- v. **Internal reporting and escalation –**
  - A. **Internal reporting.** The program must identify the circumstances under which persons responsible for portfolio management will be informed regarding the operation of the program, including exceedances of the guidelines specified in paragraph 1.ii. of these conditions and the results of the stress tests specified in paragraph 1.iii. of these conditions.
  - B. **Escalation of material risks.** The derivatives risk manager must inform in a timely manner persons responsible for portfolio management of the fund, and also directly inform the board as appropriate, of material risks arising from the fund's derivatives transactions, including risks identified by the fund's exceedance of a criterion, metric, or threshold provided for in the fund's risk guidelines established under paragraph 1.ii. of these conditions or by the stress testing described in paragraph 1.iii. of these conditions.
- vi. **Periodic review of the program.** The derivatives risk manager must review the program at least annually to evaluate the program's effectiveness and to reflect changes in risk over time. The periodic review must include a review of the VaR calculation model used by the fund under condition 2 below (including the backtesting required by paragraph 1.iv. of these conditions) and any designated reference portfolio to evaluate whether it remains appropriate.

2. **Limit on fund leverage risk.**

- i. The fund must comply with the relative VaR test unless the derivatives risk manager reasonably determines that a designated reference portfolio would not provide an appropriate reference portfolio for purposes of the relative VaR test, taking into account the fund's investments, investment objectives, and strategy. A fund that does not apply the relative VaR test must comply with the absolute VaR test.
- ii. The fund must determine its compliance with the applicable VaR test at least once each business day. If the fund determines that it is not in compliance with the applicable VaR test, the fund must come back into compliance promptly after such determination, in a manner that is in the best interests of the fund and its securityholders.
- iii. If the fund is not in compliance with the applicable VaR test within five business days,

- A. The derivatives risk manager must provide a written report to the board and explain how and by when (i.e., number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance;
- B. The derivatives risk manager must analyze the circumstances that caused the fund to be out of compliance for more than five business days and update any program elements as appropriate to address those circumstances; and
- C. The derivatives risk manager must provide a written report within thirty calendar days of the exceedance to the board explaining how the fund came back into compliance and the results of the analysis and updates required under paragraph 2.iii.B. of these conditions. If the fund remains out of compliance with the applicable VaR test at that time, the derivatives risk manager's written report must update the report previously provided under paragraph 2.iii.A. of these conditions and the derivatives risk manager must update the board on the fund's progress in coming back into compliance at regularly scheduled intervals at a frequency determined by the board.

3. ***Board oversight and reporting –***

- i. ***Approval of the derivatives risk manager.*** The board, including a majority of independent directors of the fund manager, if any, must approve the designation of the derivatives risk manager.
  - ii. ***Reporting on program implementation and effectiveness.*** On or before the implementation of the program, and at least annually thereafter, the derivatives risk manager must provide to the board a written report providing a representation that the program is reasonably designed to manage the fund's derivatives risks and to incorporate the elements provided in paragraphs 1.i. through vi. of these conditions. The representation may be based on the derivatives risk manager's reasonable belief after due inquiry. The written report must include the basis for the representation along with such information as may be reasonably necessary to evaluate the adequacy of the fund's program and, for reports following the program's initial implementation, the effectiveness of its implementation. The written report also must include, as applicable, the derivatives risk manager's basis for the approval of any designated reference portfolio or any change in the designated reference portfolio during the period covered by the report; or an explanation of the basis for the derivatives risk manager's determination that a designated reference portfolio would not provide an appropriate reference portfolio for purposes of the relative VaR test.
  - iii. ***Regular board reporting.*** The derivatives risk manager must provide to the board, annually or at such other frequency determined by the board, a written report regarding the derivatives risk manager's analysis of exceedances described in paragraph 1.ii. of these conditions, the results of the stress testing conducted under paragraph 1.iii of these conditions, and the results of the backtesting conducted under paragraph 1.iv of these conditions since the last report to the board. Each report under this paragraph must include such information as may be reasonably necessary for the board to evaluate the fund's response to exceedances and the results of the fund's stress testing.
4. [Not applicable]
5. [Not applicable]

6. **Recordkeeping –**

- i. **Records to be maintained.** A fund must maintain a written record documenting the following, as applicable:
  - A. The fund’s written policies and procedures required by paragraph c.1. of these conditions, along with
    - 1. The results of the fund’s stress tests under paragraph 1.iii. of these conditions;
    - 2. The results of the backtesting conducted under paragraph 1.iv. of these conditions;
    - 3. Records documenting any internal reporting or escalation of material risks under paragraph 1.v.B. of these conditions; and
    - 4. Records documenting the reviews conducted under paragraph 1.vi of these conditions.
  - B. Copies of any materials provided to the board in connection with its approval of the designation of the derivatives risk manager, any written reports provided to the board relating to the program, and any written reports provided to the board under paragraphs 2.iii.A. and C. of these conditions.
  - C. Any determination and/or action the fund made under paragraphs 2.i. and ii. of these conditions, including a fund’s determination of: The VaR of its portfolio; the VaR of the fund’s designated reference portfolio, as applicable; the fund’s VaR ratio (the value of the VaR of the fund’s portfolio divided by the VaR of the designated reference portfolio), as applicable; and any updates to any VaR calculation models used by the fund and the basis for any material changes thereto.
- ii. **Retention periods.**
  - A. A fund must maintain a copy of the written policies and procedures that the fund adopted under condition 1. that are in effect, or at any time within the past seven years were in effect, in an easily accessible place.
  - B. A fund must maintain all records and materials that paragraphs 6.i.A.1. through 4. and 6.i.B. through D. of these conditions describe for a period of not less than seven years (the first two years in an easily accessible place) following each determination, action, or review that these paragraphs describe.