Eric Adelson
Senior Vice President and Head of Legal
T: 416.228.3670
F: 416.590.1621
Email: eric.adelson@invesco.com

Invesco
5140 Yonge Street, Suite 800
Toronto, Ontario M2N 6X7
Telephone: 416.590.9855 or 1.800.874.6275
Facsimile: 416.590.9868 or 1.800.631.7008
www.invesco.ca

March 12, 2014

VIA E-MAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:
The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
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")

We are writing in respect of the request for comments dated December 12, 2013 regarding the Proposal. We appreciate the opportunity to comment on these important matters.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide build their financial security. As of January 31, 2014, Invesco and its operating

subsidiaries had assets under management of approximately US$765 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

Invesco Canada is registered as an Investment Fund Manager, an Adviser and a Dealer in Ontario and certain other provinces. Our investment products are primarily bought by and sold to retail investors. As such, we take a great interest in regulatory discussions that impact those investors.

We have read the Proposal and have previously participated in an Ontario Securities Commission ("OSC") discussion group relating to the Proposal. This meeting (the "Pre-Consultation") was held on September 26, 2013 and included ourselves, academics, institutional investors, representatives of the Canadian banks, representatives of both the ETF industry and the Investment Funds Institute of Canada ("IFIC"), and a representative of the Canadian Foundation for Advancement of Investor Rights, as well as members of Staff of the OSC. Prior to the Pre-Consultation, participants were provided with a draft proposed risk classification methodology along with background material. We note that this background material, which included strong evidence to support the position of the Canadian Securities Administrators ("CSA") regarding use of a 10 year standard deviation measure (as opposed to a shorter time period), was not published with the Proposal. In reading some of the comments posted to March 7, 2014, we believe that it would be helpful for all commenters if the CSA published the background material as it would answer some of the questions posed to date. The Pre-Consultation was a 4 hour meeting which required several multiples of that time for preparation. Despite the diversity of attendees, many of the comments made during the Pre-Consultation were agreed upon by all or all but one of the 12 attendees. None of these comments have been reflected in the Proposal and it is our understanding, after consulting with Staff of the OSC, that such non-inclusion was due solely to time considerations and those comments will be considered together with comments on the Proposal. In addition, participants were provided with a list of questions for consideration, many of which are included in the Proposal. We provided written responses to those questions to Staff of the OSC and have been advised that such comments will also be considered during the review of comments on the Proposal. We would have no objection to publication of such comments. As such, we have decided to limit our comments on the Proposal to the most important issues that affect us and also to address some of the comments on the Proposal posted as of March 7, 2014.

History of Fund Risk Classification

We believe that it would be beneficial to all to consider the history of fund risk classification in Canada as mandated by the CSA. In 2000, CSA members passed National Instrument 81-101 ("NI 81-101"), replacing National Policy 36. NI 81-101 changed the form requirements for simplified prospectuses through Form 81-101F1 and included, for the first time, the requirement that a mutual fund "indicate the level of investor risk tolerance that would be appropriate for investment in the mutual fund" (the "Risk Classification Requirement"). This is a requirement in Form 81-101F1 that was not carried over from NP 36.

The Risk Classification Requirement was problematic because the CSA offered no guidance at the time as to how a mutual fund should determine the level of risk tolerance for an investment in the fund. Mutual fund manufacturers asked the CSA for guidance on this point yet, for reasons no longer relevant, such guidance was not provided. This caused problems within the industry as similar funds had dissimilar rankings and this impacted fund flows. As you can imagine, once flows are impacted, fund managers were incentivized to ensure the lowest possible reasonable risk classification for its funds. As an industry, we were all rather concerned with this state of affairs and looked to the industry's trade

association, IFIC, for a solution. To its credit, IFIC put together a working group to study this issue, looking at many different measures of risk as well as many different timeframes during which to measure risk and, based on this research, devised its recommendation to members regarding fund risk classification. The key elements of the IFIC approach were: 5 year standard deviation based on monthly returns, categorization in 6 bands (since reduced to 5) based on standard deviation ranges, default classification categories for funds with inadequate history, and the ability of the fund manager to deviate from the recommendation if a suitable explanation was provided. We believe that over 90% of the fund industry has adopted the IFIC approach.

In 2008, the CSA proposed adopting the IFIC approach for the Fund Facts Document but, for reasons that remain unclear, IFIC resisted that plan and the situation was left unresolved. We note that there is not uniform acceptance of the IFIC approach. Investor advocates are often critical of any proposal by IFIC and IFIC's fund risk classification approach is no different. Put simply, there is a lack of trust expressed by deep skepticism of anything produced by IFIC or mutual fund manufacturers generally. This suggests that a solution mandated by the CSA is required. With the advent of the Fund Facts Document a CSA-mandated solution is more important because the Fund Facts Documents are designed in a way that enables potential investors to compare mutual funds quite easily. Unfortunately, if mutual funds do not classify risk on the same basis, a key objective of the Fund Facts Document is diluted.

What is not clear at this time is whether the CSA intends for the Proposal to apply to Item 10 in Part B of Form 81-101F1, being the requirement to state the risk tolerance for an investment in the fund. We note that the title of the Proposal refers to the Fund Facts Document but we see no reason why there should be any difference between the simplified prospectus and the Fund Facts Document on this point. As such, we recommend that the CSA make clear that its proposed methodology would apply equally to Item 10 of Part B of Form 81-101F1.

Meaning of Risk

What has struck us in reading the letters posted by investors and investor advocacy groups, including the Investor Advisory Panel established by the OSC, is that regulators and the industry have defined risk primarily as variability of returns whereas investors are much more concerned with risk of loss. This latter concept forms the foundation to their objections to use of a standard deviation measure. We note that some of the investor letters have noted instances where standard deviation is appropriate, but we believe many of those letters have made a compelling case for why it is insufficient and potentially misleading. Those to whom the Fund Facts Document is targeted have made rather clear their concerns with using standard deviation as the methodology to classify fund risk and they have also made quite clear their concerns with a rating system due to the potential misuses of a single classification system.

We have been using standard deviation for many years and are comfortable with its use and calculation. As such, we generally support the CSA's approach. However, for many years we have had a real issue with the names given to the risk classification bands as we believe that is misleading and leads to misuse and do not support that aspect of the Proposal. However, we do not feel that it is in anyone's interest to ignore the pleas of the target audience for this document and, as such, we support some of the alternatives suggested in other letters that Fund Facts Document risk disclosure should focus more on risk of loss than on variability of returns.

__Invesco Canada's Principal Concerns__

We have three major concerns with the Proposal: (1) use of reference index data; (2) nomenclature of the prescribed risk bands; and (3) misuse of risk classification.

Use of Reference Index Data

Invesco Canada offers funds under the Trimark, PowerShares and Invesco brands. Each brand has unique characteristics but our comments focus on our Trimark-branded funds, which account for the majority of the assets managed by Invesco Canada. Trimark Funds share the following characteristics: concentrated portfolios (typically not more than 40 positions, although there are some exceptions); sector allocation that bears no resemblance to that of any benchmark index; all leading to different risk profiles than the index. As has been observed both by the CSA and the investors who have made submissions, many mutual funds in Canada do not have 10 year histories and, therefore, will need to supplement the gap in time with use of a reference index. In the case of the Trimark funds – and any mutual fund that follows a value-based approach and has a concentrated portfolio – it will be impossible to construct a reference index that conforms to the second bulleted list (beginning "Ideally, the reference index should…") in section 6 of the Proposal.

The use of a reference index as written is highly problematic as we believe it will lead to misleading classification results for our funds. Our funds are designed to not look like any index and to perform differently from an index. By substituting an index for actual fund performance, the risk of the fund may be overstated or understated and this problem will be greater the younger a fund is because the younger the fund the more years of reference index performance it will have to use.

We note that section 6 requires the use of a reference index or a blended index comprising "a weighted combination of acceptable indices". We do not know what the phrase "acceptable indices" means. We note that there are already two similar definitions in use in National Instrument 81-102 – Mutual Funds ("NI 81-102"), "index participation units" ("IPU") and "permitted index", and do not believe that it is helpful to add a third variant. An index fund must be based on a "permitted index" which requires that the index is (1) a market index, (2) administered by an organization unaffiliated with the manager of the fund, (3) is available to persons or companies other than the fund, and (4) is widely recognized and used. In contrast, an IPU must be based on (1) a market index and (2) it must be widely-quoted. The most important difference between these two definitions is that a permitted index is widely recognized and used whereas an index used in an IPU is widely quoted. One might surmise that widely-quoted is simply a short form of saying widely recognized and used but the CSA has not adopted this interpretation and has clearly applied the two definitions differently. As such, one is left to wonder which of these two definitions – or perhaps some third definition – is contemplated in section 6 of the Proposal.

The Proposal attempts to clarify this by stating the characteristics that an "acceptable index" __should__ have, one of which is that the index __should__ be widely recognized and available. (Note that legislation and regulation drafted with extensive use of the word "should" is often unhelpful and leads to confusion. This increases the costs of compliance and is unnecessary.) While this sounds similar to the wording used in the definition of "permitted index", we note that "available" and "used" have rather different meanings. We prefer "available" since availability is much easier to determine than use and, as such, if such terminology is adopted, we recommend that the word "available" replace the word "used" in the definition of "permitted index" (which would also simplify drafting since Item 6 can then use the term "permitted index"). Applying this aspect of the reference index

requirement is likely not problematic, however, because all funds are required to have some sort of benchmark for use in the management report of fund performance ("MRFP") and, presumably, mutual funds would be permitted to use such benchmarks for this purpose. However, the Proposal is not clear on that part and the second bulleted list of section 6 contradicts that.

The second bulleted list in section 6 simply does not work with funds managed in the manner of Trimark funds. The CSA states that "ideally, the reference index…should comply with the following principles" (note that we are deeply concerned with any regulatory requirement using the words "ideally" and "should" in the same sentence since such is simply guidance that can be completely ignored):

- "have returns highly correlated to the returns of the fund" – our funds generally are not highly correlated to their indices: this is their value proposition. Also, there is no definition of "highly correlated" in the Proposal nor is there any guidance as to the meaning of this phrase offered anywhere in Canadian securities law. We note that the phrase "highly correlated" is used in the definition of "hedging" in NI 81-102 and some fund managers interpret that as meaning as correlation as low as 50%.

- "Contain a high proportion of the securities represented in the fund's portfolio with similar portfolio allocations" – other than a closet index fund, we do not believe it is possible for most active managers to meet this requirement and we know it is not possible in the case of Trimark funds which typically have 20% or less overlap in names (not weightings) with the benchmark index.

- "share the same style characteristics and reflect the market sectors in which the fund is investing" – we are unclear how to apply the first part of this requirement since we have seen the same stocks classified as both value stocks and growth stocks depending on who was making the classification. More importantly, Trimark fund sector allocations do not in any way follow their benchmark's sector classification and, as such, it would be impossible to meet this criteria.

We suspect the CSA's response to the foregoing criticism will be that these requirements are qualified by the words "ideally" and "should" and therefore should be construed as guidance that should be employed only where practical. While this would be ideal, our experience is that Staff does not interpret such words in that manner. To address the deficiencies with the guidance on selection of a reference index and to avoid the interpretive issues noted at the beginning of this paragraph, we strongly urge the CSA to provide fund managers, in the final form of any rule based on the Proposal, with a "safe harbor" should they use the same benchmark for this purpose as is used in the MRFP.

To summarize, if the CSA is intent on using a standard deviation-based single rating system using 10 years of monthly returns supplemented by a reference index where necessary, we make the following recommendations:

- Revise the definition of "permitted index" in NI 81-102 to replace the word "used" with "available"

- Require that a reference index be a permitted index or a blend of permitted indices weighted in accordance with the fund's investment objectives and strategies

- Explicitly state that the permitted index for use in this context can be the index used for the benchmark in the MRFP and that if a benchmark is used in addition to the broad based benchmark, the additional benchmark should be used as the reference index

- Explicitly state that a fund manager that uses the MRFP benchmark will be deemed to be in full compliance with applicable regulation and that such use offers the fund manager a full defense to any claims of misrepresentation relating to the use of reference index data

- Explicitly state that CSA members will grant relief from this requirement when it is not possible to find a reference index containing at least two of the following four criteria set out in the Proposal:

  • whenever possible, have returns highly correlated to the returns of the fund

  • contain a high proportion of the securities represented in the fund's portfolio with similar portfolio allocations

  • share the same style characteristics and reflect the market sectors in which the fund is investing

  • have security allocations that represent investable position sizes on a pro rata basis to the fund's total assets

- Provide for at least a 1 year transition period to allow truly active managers sufficient time to consider an alternative and apply to their principal regulator for relief from this requirement.

Nomenclature of the Prescribed Risk Bands

As noted above, the industry has been using the IFIC approach for many years. The “medium” category under that approach includes a standard deviation between 11% and 16%, whereas under the Proposal that category has a standard deviation of 6% to 12%. There is very little overlap between these two “medium” categories and this causes several issues.

First, there is potential obvious confusion to the public when the same terminology is used in 2 different approaches to risk classification but the terms have much different meanings in the two. We do not believe this can be addressed through concentrated education initiatives by the CSA or by the industry. Put simply, there is no evidence that education initiatives of this type of concept will have any impact whatsoever.

Second, the term medium risk implies a normative judgment. It is not clear, however, the basis for the CSA determining that a fund with a standard deviation of 6%-12% is the correct investment for any individual nor do we believe that any normative judgment should be based on standard deviation. As some of the investor advocates and the Investor Advisory Panel have pointed out, this means a performance range of +/- 24%, or a performance range equal to 48%, 95% of the time. (We also agree that it is difficult for anyone to use this measure without attaching it to an average performance measure and, for funds with less than 10 years of history, the Fund Facts Document does not provide such measure.) For an investor concerned with risk of loss, we do not see the connection between their concerns and a medium rating with the foregoing meaning.

This can be addressed in one of two ways. If the CSA wishes to make a normative judgment, it must consider an anchor around which the structure is built. Using a word such as "medium" implies that this is the typical comfort level of an individual investor. Given investment trends over the last several years, it appears to us that most investors are comfortable with a balanced portfolio. A balanced Canadian portfolio comprising 60% Canadian stocks and 40% Canadian government fixed income has a standard deviation of 11% (based on annual returns over the past 110 years) and, when measured in 10 year increments, the standard deviation of that volatility is 3.5%[1], implying a standard deviation range of 7.5% to 14.5% for the portfolio. The CSA should consider using such a portfolio to anchor its ranking system and apply that range to the medium category. Medium could then be explained to investors as the variability of returns one would typically expect from a balanced portfolio and it may make for more meaningful comparisons.

The other way to address this, and our preferred solution, would be to drop the nomenclature of low, medium and high and adopt a numerical scale. This has been suggested in some of the comments on the Proposal posted to date and seems to us to make a lot of sense. It eliminates confusion with the IFIC approach, it eliminates confusion with dealer suitability analysis (see discussion below regarding misuse of classifications) and it provides the information in a relative manner without making a normative judgment. As such, an investor will know that a fund with a rating of 6 (on a 6 point scale) is riskier than a fund with a rating of 5, which is really all that a scale can tell us with accuracy. In contrast, the nomenclature used in the Proposal could easily provide investors with a false sense of security about their investment.

Whether a numerical scale should be a 6 point, 10 point or 20 point scale is a valid question. While we would support any alternative to the current nomenclature, we believe a 6 point scale would be least likely to be misused. In using a 10 point scale, we believe that it would be quite foreseeable for an investor to believe that a fund with a risk rating of 3 is 10% less "risky" than a fund with a risk rating of 4. A 6 point scale does not lead the mind to a similar conclusion. In our view, a 20 point scale parses the data too finely and reduces the meaning of different data points. It also has the potential of making the riskiest funds sound less risky and of making lower risk funds sound riskier than they probably are (not to mention that it would increase the frequency of rating classification changes for a particular mutual fund).

Misuse of Risk Classification

As the CSA is well aware, under MFDA rule MR-0069, the suitability analysis is tied into the fund risk classification as disclosed in the simplified prospectus. We believe that the MFDA has taken this position because it is simple and easy to use. However, it is incorrect in both theory and practice because, among other reasons, it ignores the impact of portfolio construction. Beyond that comment, we will not delve into the reasons for this as we believe those investor letters that have addressed this issue have done so clearly and convincingly. As such, we believe that it is absolutely vital that the CSA work with the MFDA on this initiative so as to ensure this misuse of fund risk classification does not continue. If the CSA fails to do so and proceeds with the Proposal as written, it is clear that there will be a massive churn of mutual fund investments within client portfolios and there would be no basis for such turnover other than the fact that the CSA adopted different risk bands than IFIC. With respect, that is just a dumb reason for turning over a portfolio and that outcome must be avoided.

[1] Source: University of Toronto Asset Management, internal studies

We cannot overstate the disastrous consequences that would ensue. Not only would investors incur unnecessary costs associated with changes to their portfolios, but worse, the new rating system could force investors to invest heavier allocations in fixed income than they otherwise would or should, hence reducing their long term return potential. This could fundamentally alter their retirement prospects – they could be taking on more risk, in the form of outliving their retirement savings.

Conclusion

Risk classification of investments is an important issue and should not be determined in haste. The CSA should consider the letters sent in by investors, investor advocates, the Investor Advisory Panel and Dan Hallett. We believe those letters are, by and large, very thoughtful and bring a perspective to this debate that has not previously been heard. We believe those submissions are important since they come from the target audience of the Fund Facts Document or those who purport to represent such audience. We do not believe the current system of fund risk classification is terribly helpful to investors and the "outside-the-box" thinking brought forth by those submissions is valuable to the process. It is more important to get this done correctly than to get this done quickly.

Thank you for providing us with the opportunity to comment on this important initiative. We would be pleased to discuss our comments further should you so desire.

Yours very truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President and Head of Legal – Canada