

RBC Asset Management Inc.  
Royal Trust Tower, 37th Floor  
77 King Street West  
Toronto, ON M5W 1P9

Phillips, Hager & North Investment Management Ltd.  
Waterfront Centre  
20<sup>th</sup> Floor, 200 Burrard Street  
Vancouver, BC V6C 3N5

February 10, 2008

**Via E-Mail**

John Stevenson  
Secretary  
Ontario Securities Commission  
20 Queen Street West  
19<sup>th</sup> Floor, Box 55  
Toronto, ON M5H 3S8

Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
Tour de la Bourse  
800 square Victoria  
C.P. 246, 22 étage  
Montreal, QC H4Z 1G3

Dear Mr. Stevenson and Ms. Beaudoin,

**Re: CSA Consultation Paper 11-405: Securities Regulatory Proposals Stemming from the 2007- 08 Credit Market Turmoil and its Effect on the ABCP Market in Canada**

We are writing in response to a request for comments from the Canadian Securities Administrators' Consultation Paper 11-405: *Securities Regulatory Proposals Stemming from the 2007- 08 Credit Market Turmoil and its Effect on the ABCP Market in Canada* published on October 6, 2008 (the "Consultation Paper").

This letter is written on behalf of RBC Asset Management Inc. ("RBC AM") and Phillips, Hager & North Investment Management Ltd. ("PH&N"). RBC AM and PH&N are indirect, wholly-owned subsidiaries of the Royal Bank of Canada and provide a broad range of investment services to investors through mutual funds, pooled funds and separately managed portfolios. We welcome this opportunity to provide our views on selected issues under examination by the Canadian Securities Administrators (the "CSA") in the area of the asset-backed commercial paper ("ABCP") market in Canada.

As a general comment, we note that the Consultation Paper examines in great detail developments surrounding the non-bank sponsored portion of the ABCP market in Canada and the role it played in the credit market turmoil in Canada. However, the regulatory proposals stemming from these events appear to encompass all types of ABCP, without differentiation between bank sponsored and non-bank sponsored ABCP. Bank sponsored ABCP typically benefits from the liquidity support, as well as the credit enhancement and administration services that is provided by the sponsoring bank. As a result, bank sponsored ABCP issuers were able to continue rolling over their ABCP with minimum disruption during extremely difficult credit conditions. In contrast to this, the Canadian non-bank sponsored ABCP market froze in August 2007 as the result of liquidity guarantees that were not as robust as those included in similar bank sponsored ABCP products. From a regulatory perspective, this should serve as a basis for treating bank-sponsored ABCP differently than non-bank sponsored ABCP. It is noted that NI 81-102 contains examples of preferences given to securities associated with a Canadian financial institution or a bank listed under Schedule 1 of the Bank Act.

The following are our comments on the specific proposals and questions that were asked in the Consultation Paper.

### **CSA Proposal #3: Accredited Investor and \$150,000 Exemption Thresholds**

The Committee proposes a separate policy review to consider the appropriateness of (i) the income and net financial asset thresholds in the accredited investor definition, and (ii) the \$150,000 exemption.

*Although it is not clear whether the proposed review of the thresholds would be limited to the proposed asset-backed short-term debt category, we wish to point out that any broad assessment of the thresholds would have an impact on all other investments sold pursuant to the accredited investor definition. We do not believe that the failure of non-Bank sponsored ABCP and the hardship suffered by individuals who invested a significant portion of their assets in these securities should be linked to the existing accredited investor regime. Had non-bank sponsored ABCP been offered pursuant to a prospectus there is no guarantee that investors would have understood the true risks of these securities because many rating agencies, investment advisors and issuers of these securities did not understand the true risk of the securities. We suggest that alternatives be considered, such as enhanced disclosure requirements and rigorous suitability assessments.*

### **CSA Proposal #4: Credit Ratings**

1. Should the CSA reduce its reliance on credit ratings in Canadian securities rules and policies?

*With respect to the use of credit ratings as a minimum threshold or eligibility criteria for certain types of investments (such as for money market funds), it is important to note that an issuer's credit rating by a third party is only one of several criteria that are used by professional investment managers in performing their own analysis (including their own credit analysis) in*

*determining whether or not to purchase a particular security. To the extent that a minimum threshold is required under securities regulation in this context, it does not mean that a minimum credit rating will serve as the sole basis for making an investment decision; rather the minimum credit rating requirement will simply serve as a base level or starting point (at least with respect to credit risk) from which an investment decision can be made.*

*As a general matter, Credit Rating Agencies bring economies of scale to the marketplace for market participants. They also provide additional information for buy-side participants that contribute to their own detailed credit quality assessment. Furthermore, to the extent that regulatory requirements are imposed on Credit Rating Agency firms, including requirements to provide additional transparency and information regarding how the Credit Rating Agency rated a particular security, they would allow professional investment managers to conduct more thorough due diligence and analysis of the rating.*

2. Do you think that any of the alternatives to credit ratings uses identified above would be a better substitute for a credit rating?

*As outlined above, we do not believe that credit ratings should be replaced with alternatives. Rather, credit ratings are used an important initial step in thorough credit analysis that must be performed for all investments. To the extent that additional disclosure is required by Credit Rating Agency firms relating to their assessment, ratings of securities will be of more benefit to the industry than using a substitute for it.*

*Furthermore, with regard to ABCP and other complex investment products, RBC AM encourages regulators to mandate more fulsome disclosure obligations. By requiring ABCP sponsors to provide timely information on the conduit's underlying assets (such as level of delinquencies, default rates or level of enhancements available) and its structure (i.e. holdings), portfolio managers will be able to conduct enhanced due diligence and more effective ongoing assessments of portfolio risk.*

## **CSA Proposal #7: Mutual Fund Investments**

The Committee proposes to review:

- i. whether a concentration restriction in National Instrument 81-102 for money market funds is appropriate, and if so, whether the current 10% concentration restriction is appropriate

*The current 10% concentration restriction that applies for money market funds is sufficient, and any further tightening of this restriction would likely have a significant negative impact on the ability of these funds to hold a portfolio of high-quality, short-term debt. This arises from the fact that in Canada, there is a limited supply of highly-rated short-term debt that a money market fund can invest in. To further restrict the ability of money market funds to invest in a particular issue may lead to unintended consequences, such as requiring funds to hold poorer quality paper overall in order to comply with concentration restrictions. The 5% concentration restriction applicable to money market funds regulated in the U.S. is not appropriate for the Canadian market which is more concentrated with the result of a significantly smaller supply of short-term debt.*

- ii. whether to further restrict the types of investments (such as asset-backed short-term debt) a money market fund can make

*To further restrict the types of investments that a money market fund can make will also likely have a negative impact on the portfolios of these funds. While some ABCP investments may be complex, we do not think that ABCP is inherently any “riskier” than many other asset classes as long as it is understood and properly analyzed. Registered, professional portfolio managers of money market funds regulated in Canada have the resources to conduct appropriate due diligence on ABCP issuers and their underlying assets. It is also important to note that ABCP comprises approximately 30% of the total Canadian money market instruments. Therefore, restricting a fund from participating in such a predominant asset class is not only unnecessary, it would also likely cause harm to a fund’s portfolio.*

- iii. whether assets such as asset-backed short-term debt are appropriate eligible assets in the definition of “cash cover” and “qualified security”

*Further restricting the scope of what constitutes cash cover for the purposes of NI 81-102 is not in the best interests of a fund. The “cash cover” component of a portfolio is managed, like the rest of a fund’s portfolio, to ensure appropriate diversification and credit quality. In many cases, bank sponsored ABCP has higher credit quality and lower credit and liquidity risk than other categories of “cash cover” and therefore eliminating ABCP as an option may ultimately increase the risk profile of a fund’s cash cover. Although hindsight may call into question the ratings assigned to certain non-bank sponsored ABCP, appropriate due diligence by investment managers and an ongoing assessment of portfolio risks are the appropriate mechanisms to address this issue, rather than eliminating ABCP as an option altogether. Our view is that ABCP can be an appropriate asset designated as cash cover and it has a role in a professionally managed mutual fund. The concerns associated with having individuals investing a significant portion of their savings directly in third-party ABCP are clearly distinguishable from how professionally managed mutual funds use ABCP in managing the credit risk of their cash cover.*

- iv. whether short-term debt investments, including ABCP with a specified credit rating, should be permitted to be aggregated in a statement of investment portfolio.

*We have no opinion as both RBC AM and PH&N break out these investments in any event.*

#### CSA’s Specific Requests for Comments on Proposal #7:

1. One of the goals of the Committee is to reduce reliance on credit ratings in securities legislation, where appropriate. Is the SEC proposal to replace the ratings test for money market funds with a “minimal credit risk” test (as determined by the board of directors of the money market fund) for investment eligibility a better approach than relying on credit ratings for investment eligibility? If so, given that most mutual funds in Canada do not have a board of directors, who would perform this function? Would a “minimum credit risk” test make it more difficult to manage a money market fund or create greater uncertainty and unintended risks?

*As it stands, there is not much clarity around the “minimum credit risk” test. It is our recommendation to maintain references to credit ratings in securities legislation as they are well understood by market participants, clear, easily measured and are uniformly applied. That is to say, they provide a clear and transparent minimum threshold for investing, and are not subject to interpretation by a mutual fund’s board of directors’ or any other body assigned with this function. Any additional regulation and disclosure obligations imposed on Credit Rating Agency firms will also be of benefit and should allow a more fulsome analysis to be completed by professional investment managers. As already stated, credit ratings are only one of the many pieces of information used in assessing the appropriateness of an investment.*

2. Given the impact of ABCP on mutual funds, are any other regulatory changes needed? Would guidance be more effective at helping mutual fund managers and portfolio managers understand the factors they need to consider when determining an appropriate investment mix for their money market funds?

*No, we don’t feel that guidance is required in the context of managing money market fund portfolios for mutual funds. In our view, portfolio managers already have a sufficient level of knowledge and expertise and have access to sufficient risk management practices, internal systems and risk-analysis-related information all of which allows them to make appropriate investment decisions with respect to all relevant asset classes, including ABCP, without the need for further regulatory changes or restrictions.*

Thank you for the opportunity to submit our comments. We would be pleased to discuss with you any of the matters outlined in this letter.

Yours truly,



Daniel E. Chornous, CFA  
Chief Investment Officer  
RBC Asset Management Inc. and  
Phillips Hager & North Investment Management Ltd.

- c. British Columbia Securities Commission  
Alberta Securities Commission  
Frank Lippa, CFO & COO, RBC Asset Management Inc.  
Brian Walsh, CFO, Phillips Hager & North Investment Management Ltd.  
Carol Sands, CCO, RBC Asset Management Inc.