



VIA E-MAIL

January 14, 2011

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
Saskatchewan Financial Services
Commission

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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada

Thank you for the opportunity to comment on Consultation Paper 91-401 relating to Over-the-Counter (OTC) derivatives regulation in Canada.

Invesco Trimark Ltd. is registered as an adviser under the category of portfolio manager in Ontario and several other provinces of Canada. As a portfolio manager, we manage investment funds, pooled funds and separately managed accounts for Canadian retail and institutional investors. As of December 31, 2010, we had approximately \$27 billion of assets under management. Invesco Trimark Ltd. is an indirect wholly-owned subsidiary of Invesco Ltd., a global investment management firm with over \$616 billion (USD) in assets under management worldwide.

In managing investments for our clients, we use derivatives for both hedging and non-hedging purposes. The majority of our assets in Canada are managed in mutual funds that are subject to National Instrument 81-102 – *Mutual Funds* and the restrictions on derivatives contained therein. Outside of those mutual funds, we typically use OTC derivatives for hedging purposes (primarily currency, but also interest rates). We also use standardized futures in managing certain mandates. Our comments in this letter pertain primarily to that part of our business focussed on NI 81-102 mutual funds.

We generally believe that, insofar as regulated mutual funds are concerned, the current system works adequately for derivative transactions that are entered into for hedging purposes and, as such, regulatory initiatives relating to standardization of OTC derivative transactions are unnecessary for hedging transactions. Hedging by its very nature is designed to eliminate or reduce a particular identified risk for an investor and one way in which the effectiveness of a hedge is measured is in relation to its cost. Cost arises primarily in two areas: counterparty spread, or what the counterparty charges for the hedging transaction; and tax impact. It is certainly possible that the first cost cited will not necessarily be impacted materially by a standardization requirement; however, we would expect there to be a significant tax impact if foreign currency hedging transactions were



standardized. Engaging in a standardized transaction may reduce the quality of the “match” between the hedge and the exposure for tax purposes, resulting in a greater likelihood that gains or losses on the hedge will be treated on account of income, rather than capital, which necessarily entails a higher cost to the end investor. As such, market participants who hedge foreign currency may find it no longer economic to do so and thereby expose investors to additional foreign currency risks. We do not believe that increasing risk to investors, in any form, is a desirable result of these reforms. We note that the Consultation Paper supports, to a degree, exemptions for true hedging transactions and we fully support that concept. We encourage the Canadian Securities Administrators (CSA) to work with other regulators (including the Canada Revenue Agency, due to tax implications that arise from designating a transaction as a hedging transaction) and legislators to arrive at a common definition for hedging so that tax laws and securities laws are consistent in that regard.

Related to the foregoing is the concept of central clearing which we do not believe is necessary for hedging transactions. Central clearing comes with a cost and we do not believe these transactions ought to be subject to additional costs as systemic risks do not typically arise from these transactions. It is important to note that systemic risks in the 2008 financial crisis became apparent in credit default swap transactions, which are non-standardized, non-cleared, anonymous transactions. For those types of transactions, we see the merits of central clearing and, due to counterparty collateral requirements, would expect central clearing to yield market benefits by making it operationally easier to perform one’s obligations under these transactions and thereby widen the universe of participants in these transactions which could serve to dissipate the risk.

In considering the issues raised by the CSA in the Consultation Paper, the regulatory community must ask what is the least that can be done to prevent recurrence of the events of 2008 and, for that reason, we generally support the proposals relating to trade repositories. It is imperative that regulators have adequate information to assess risks in real time and that would be attained by mandatory trade reporting. Of course, the regulatory community must also be given the power to act without delay on the information it receives from this process and these powers would have to be reasonably broad.

As noted previously, we support the establishment of trade repositories for the collection of all information relating to derivative trades and see no reason why this could not include hedging and non-hedging derivative transactions. We believe that required reporting should be by financial intermediaries only where at least one party to a derivative transaction is a financial intermediary. Where transactions involve two non-financial intermediaries, a reporting obligation should arise only if the notional amount of the transaction or all transactions by one such counterparty exceeds a prescribed amount that must be set sufficiently high to trigger systemic risk concerns. Systemic risk would only arise in such situations by the sheer dollar volume of transactions outstanding. Please note that as a mutual fund manager, we would consider ourselves non-financial intermediaries and do not have the infrastructure to ensure real-time reporting of these transactions and do not have the volumes necessary to justify building such infrastructure. However, in all

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cases, we deal with major financial institutions that do have the ability, or at least the volume necessary to justify creating the ability, to build such infrastructure.

In formulating rules around trade reporting, the CSA must exercise extreme caution in determining what information needs to be provided and seek only the minimum necessary to achieve the desired purpose. In all aspects of financial transactions, information has value and it is vital to ensure there are no opportunities for market abuses, such as front-running, as a result of providing this information. (This may imply that a trade repository run by a regulator rather than a third party subject to regulatory supervision is the most sensible approach.) We believe the necessary information would be price, volume and identity of the financial intermediary involved.

If a proper trade repository is established, we do not believe there is any need for mandated electronic trading. We note that there currently exist electronic trading platforms for OTC derivatives and, where feasible, market participants tend to use these as it makes the trading process more efficient. That is, without any regulatory initiative, electronic trading of OTC derivatives has been initiated and evolves and, where it makes sense to do so, it will continue to evolve.

As an investment fund manager of long-only products, we do not believe capital requirements are appropriate as there is no exposure at the firm level for derivative transactions carried out for managed accounts. Where leverage in any form is a possibility, then it may be appropriate to have a minimum capital requirement to offset the affects of leverage. We note that investment fund managers in Canada are subject to minimum capital requirements and in the history of the Canadian mutual fund industry, absent situations of fraud, we do not believe there have been any instances of harm to investors or the market as a result of a deficiency in a portfolio manager's minimum capital or that could have been avoided with a higher minimum capital requirement.

Tied into capital are collateral requirements and we generally agree with the comments in the Consultation Paper to the effect that these issues do not typically arise in the context of hedging transactions. We note that NI 81-102 mutual funds are subject to a strict regime regarding cash cover when those mutual funds enter into derivatives for non-hedging purposes. We note that the structure of these rules often results in a situation of double collateral and we believe this is completely unnecessary. We have commented separately on this in the context of comments on proposed amendments to NI 81-102 and will not repeat those comments at this time. However, we believe it is sufficient to say that any collateral or capital requirements should not be added for mutual funds regulated under NI 81-102 as there would be no benefit to doing so, yet additional requirements necessarily entail additional costs, which may be significant. In addition, to the extent collateral or capital requirements are desirable we believe such requirements should reflect (1) the creditworthiness of the end-user, (2) the tenure/duration of the contract and (3) the underlying volatility of the reference asset.

In addition, as noted above, the rules in NI 81-102 present difficulties for mutual funds to enter into non-hedging derivative transactions. We would encourage the CSA to

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re-think those rules at the same time as it gives consideration to the issues presented in the Consultation Paper so that assets used, for example, as cash cover under a derivative transaction could also be used to satisfy counterparty collateral requirements and also an explicit statement that cash held by a mutual fund can be used as collateral for derivative transactions entered into by the fund.

In regards to the specific question on page 49 of the Consultation Paper, we strongly encourage the CSA to consider exemptions for non-financial intermediaries from many of the proposals contained in the Consultation Paper. These exemptions should be based on per account exposure to counterparties in derivative transactions. We note that most mutual fund accounts are self-sufficient in that a default by one mutual fund would have no impact on the transactions of another mutual fund, even if the two mutual funds are under common management. As such, it is hard to imagine any single mutual fund ever posing any sort of systemic risk and, as such, mutual funds should not be subject to additional burdens.

Lastly, we fully support the recommendation that collateral be held in segregated accounts. NI 81-102 mutual funds typically operate in that fashion for all of their assets and this is a major investor protection feature of regulated mutual funds. We know of no cases where such segregation has caused any sorts of difficulties for any market participants and we believe it offers excellent protection for all.

We thank you for the opportunity to comment on these important matters and would be pleased to discuss the impacts of these issues on mutual funds should you so desire.

Yours Truly,

Invesco Trimark Ltd.

A handwritten signature in black ink, appearing to read "R. Chong", written over the printed name.

Rex Chong
Vice-President, Portfolio Manager

A handwritten signature in black ink, appearing to read "Eric J. Adelson", written over the printed name.

Eric J. Adelson
Senior Vice-President, Legal

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