THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

June 15, 2022

Delivered By Email: ian.tam@morningstar.com

Mr. Ian Tam
Chair, The Canadian Investment Funds Standards Committee (CIFSC)

Dear Canadian Investment Funds Standards Committee Members::

RE: Canadian Investment Funds Standards Committee Category Change Proposal May 16, 2022

The Investment Funds Institute of Canada (IFIC) is the voice of Canada's investment funds industry. IFIC brings together approximately 150 organizations, including fund managers, distributors, and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

This letter provides IFIC's response to the Category Change Proposal, May 16, 2022 (Proposal). IFIC supports CIFSC's efforts to provide a single standardized set of investment fund categories for the benefit of investors and other participants.

We would like to thank CIFSC for its consideration of IFIC's previously expressed concerns in response to the originally proposed definition for a new Multi-Sector Fixed Income category (July 2021) and we appreciate the opportunity to provide further feedback. We believe that the current proposal is a significant improvement from the July 2021 proposal. We appreciate that CIFSC addressed some of the key issues raised by IFIC, in particular:

- Removing the "High Yield" and "Tactical" label from the category name.
- Removing cash and derivatives from the list of stated broad sectors.
- Introducing quantitative tests on sector exposure and concentration.
- Reducing the flexible and qualitative aspects of the July 2021 proposal with regards to reliance on prospectus language.

IFIC however believes that there is an opportunity to further improve and refine the Proposal. Please find below our comments for consideration.

Multi-Sector Fixed Income Category – CIFSC Proposed Definition

As stated in the Proposal, "The purpose of the review is to ensure the logical, consistent categorization of investment funds and to maximize the similarity of investment strategies and risk-return profiles within each category. Categories should have a sufficient number of funds to allow for meaningful comparisons and rankings within the category."

Proposed Category Definition:

Funds in the Multi-Sector Fixed Income category have an investment mandate stating that they strategically or tactically diversify their assets across several fixed income sectors including, but not limited to, government, municipal/provincial, corporate (including preferred shares), securitized (including asset-

backed securities, collateralized loans, mortgage-backed securities, etc.), and High Yield debt. Geographic exposure can span both developed and emerging markets. Inclusion in this category may be based on i) a written fixed income allocation policy meeting the above definition (i.e. in a fund's prospectus or written investment policy) that is explicit in defining a Multi-Sector mandate; ii) a portfolio manager's or sub-adviser's stated or known approach to managing portfolios; or iii) the fund's historical fixed income allocation tendencies. Namely, funds in this category should have no more than 65% of their holdings in a single fixed income sector and should demonstrate that they span at least three fixed income sectors over time, defined as a weighted average exposure of at least 10%.

CIFSC notes that funds in this category have, or are permitted to have, an average credit quality below investment grade (Lower than BBB or equivalent) and can hold in excess of 40% of the portfolio in High Yield fixed income securities for prolonged periods of time, which would otherwise qualify the fund for the High Yield Fixed Income category.

IFIC Comments and Recommendations for Discussion

While IFIC is supportive of the creation of a Multi-Sector Fixed Income category and recommended the creation of this category (most recently in its December 4, 2020 CIFSC submission), IFIC believes that the category proposal as is currently presented falls short of fulfilling CIFSC's stated goal of creating a category that demonstrates a ***logical, consistent categorization*** *of investment funds* that *will* ***maximize the similarity of investment strategies and risk-return profiles within each category.***

Based on our understanding of the category definition and the list of the potential fund movers, the resulting peer group appears to be quite varied. The list spans several geographies, fixed income asset classes with wide range of risk and duration profiles. With large differences across several exposures, fair comparisons within a highly heterogenous "peer group" becomes very difficult. For example, the 3-year standard deviation for the proposed list ranges from low 3's to mid-11's, with a median of 6. This spans three risk rating classifications based on CSA risk rating methodology. We have examined the published proposal under this lens and identified the following main issues:

1. Insufficient granularity among the stated sectors;
2. Lack of limitations/weights on geography;
3. Measurement of sector exposure with regards to High Yield component and Hight Yield allowed range (10-65%); and
4. Low number of minimum required sectors and minimum exposure requirements (closely connected to issue #1 above).

The above components of the definition require, in IFIC's view, further refinement, not only to ensure that the Multi-Sector Fixed Income category captures the intended funds appropriately, but to avoid disruption to existing fixed income categories that might see some of their constituents leave their current categories unintentionally. Please see below for more details on the concerns raised and IFIC's recommendations.

Insufficient granularity among the stated sectors: The stated fixed income sectors are broadly defined leading to inclusion of many broad-based investment grade Canadian fixed income funds in this new category. These funds would then have significantly smaller correlation with their peer group compared to their current CIFSC category (please see Exhibit 1 and 2 in the Appendix for examples). We believe that this problem would be helped if there was further delineation of the current fixed income sectors to include sub-categories for investment grade and non-investment grade (High Yield). IFIC recommends that the stated list of sectors should show Government, Provincial, Municipal and Corporate Bonds as Investment Grade only, considering that High Yield has been added as a sector.

We would also ask CIFSC to clarify whether the following type of debt will be considered part of the Government sector, considering the similarities in their behavior with the Government bonds:

1. Canadian Provincial Bonds, and
2. Real Return/Inflation Protected Bonds

Lack of limitations/weights on geography. This may result in grouping together funds with very different risk-return profiles. To avoid comparing domestic products to global funds that face a materially different set of drivers, we recommend introducing geography weights so that funds that invest primarily in Canada should not be included. This will help avoid re-categorizing many broad-based Canadian Fixed Income funds as they seem appropriately classified in their current categories. Given the number of Canadian core plus type products caught in the initial fund list, IFIC suggests introducing a limit on the Canadian exposure (<90%). For purposes of this assessment and in line with the current CIFSC practices, up to 30% of a fund's assets that may be held in Foreign Fixed Income products will be treated as Canadian content provided that the currency exposure on those holdings is hedged into Canadian dollars. The above limit on Canadian exposure (<90%) will prevent the "non-true" Multi-Sector funds from being caught in this new category.

Measurement of sector exposure with regards to High Yield component and High Yield allowed range (10-65%). IFIC believes that High Yield corporate bonds and senior loans (i.e., non-investment grade) represent the largest contributors to credit risk and should be treated as a separate asset class from investment grade corporate bonds. While we support the treatment of High Yield debt as a standalone sector, we have concerns regarding the measurement of exposure, especially when High Yield overlaps other sectors.

Considering that most platforms from third-party data providers do not consider High Yield as a separate sector, in cases where there is an overlap between High Yield and the other stated sectors High Yield corporate debt) the calculation of exposure in each sector would require taking out the weighting of High Yield debt from the weightings of the other sectors (e.g. from corporate). Based on clarifications we received, CIFSC's intended approach does not include such adjustments. Alternatively, IFIC reiterates the above recommendation for adding more clarity on the stated sectors by showing Government, Provincial, Municipal and Corporate as being Investment Grade only, now that High Yield is a separate sector. By making this important distinction there will be no overlap of securities and names for these sector buckets.

IFIC also believes that the wide allowance of High Yield debt (10-65%) is one of the main contributors to fund divergence in this proposed category across risk/return profiles. We reiterate our recommendation for a prescribed range of 25-65% for High Yield holdings.

Low number of minimum required sectors and the minimum exposure requirements. Considering how broad the listed sectors are, the proposed 3-sector minimum exposure requirement appears low and very easy to reach. This is especially concerning when the portfolio is exposed only to defensive segments within those sectors. To rectify this issue IFIC recommends the following:

1. Using more granular sectors definitions. Stated list of sectors should show Government, Provincial, Municipal and Corporate Bonds as Investment Grade only, considering that High Yield has been added as a sector.
2. Potentially increasing the number of minimum required sectors, subject to the granularity of offered sectors.

Finally, we would like CIFSC to clarify whether inclusion of a fund in this category requires all three tests to be passed (Multi-Sector mandate, 3-sector minimum exposure over time ***and*** 10-65% exposure per sector) as implied by the flow chart, which appears to be in opposition to some of the wording included in the definition, namely:
Inclusion in this category may be based on i) a written fixed income allocation policy meeting the above definition (i.e., in a fund's prospectus or written investment policy) that is explicit in defining a multi-sector mandate; ii) a portfolio manager's or sub-adviser's stated or known approach to managing portfolios; ***or*** *iii) the fund's historical fixed income allocation tendencies.*

As always, IFIC and the Fund Categorization Working Group (FCWG) is committed to continuing to work with CIFSC to help improve processes, methodologies, and categories. As our collective experience has shown, this collaborative approach ultimately results in a more robust categorization system that better serves the needs of all who use it.

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We would be pleased to provide further information or answer any questions you may have. Please feel free to contact me by email at mteovanovic@ific.ca or, by phone 416-309-2302.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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IFIC Fund Categorization Working Group Members

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Capital Group
CIBC Asset Management Inc.
CI Global Asset Management
Desjardins Investments
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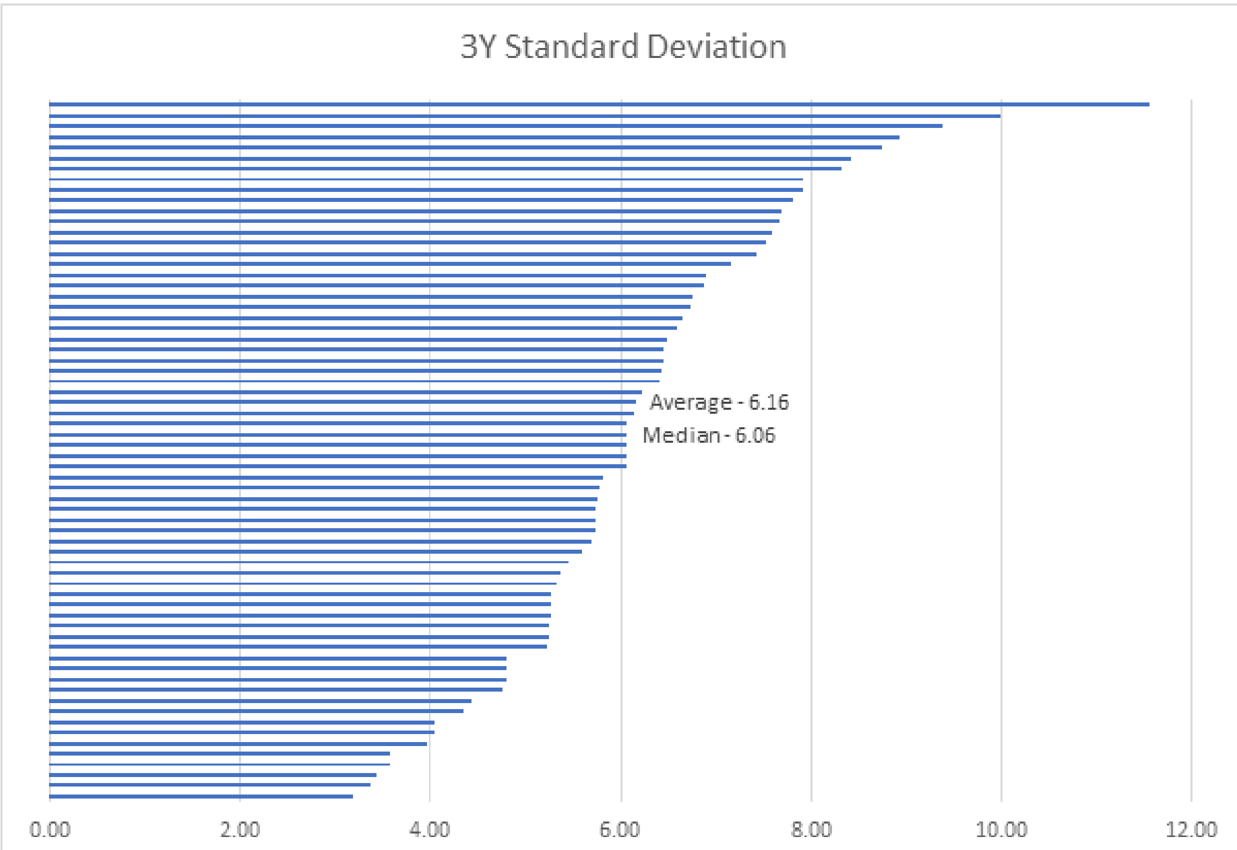
Mackenzie Financial Corporation
Manulife Financial
RBC Global Asset Management
Scotia Global Asset Management
SLGI Asset Management
TD Asset Management

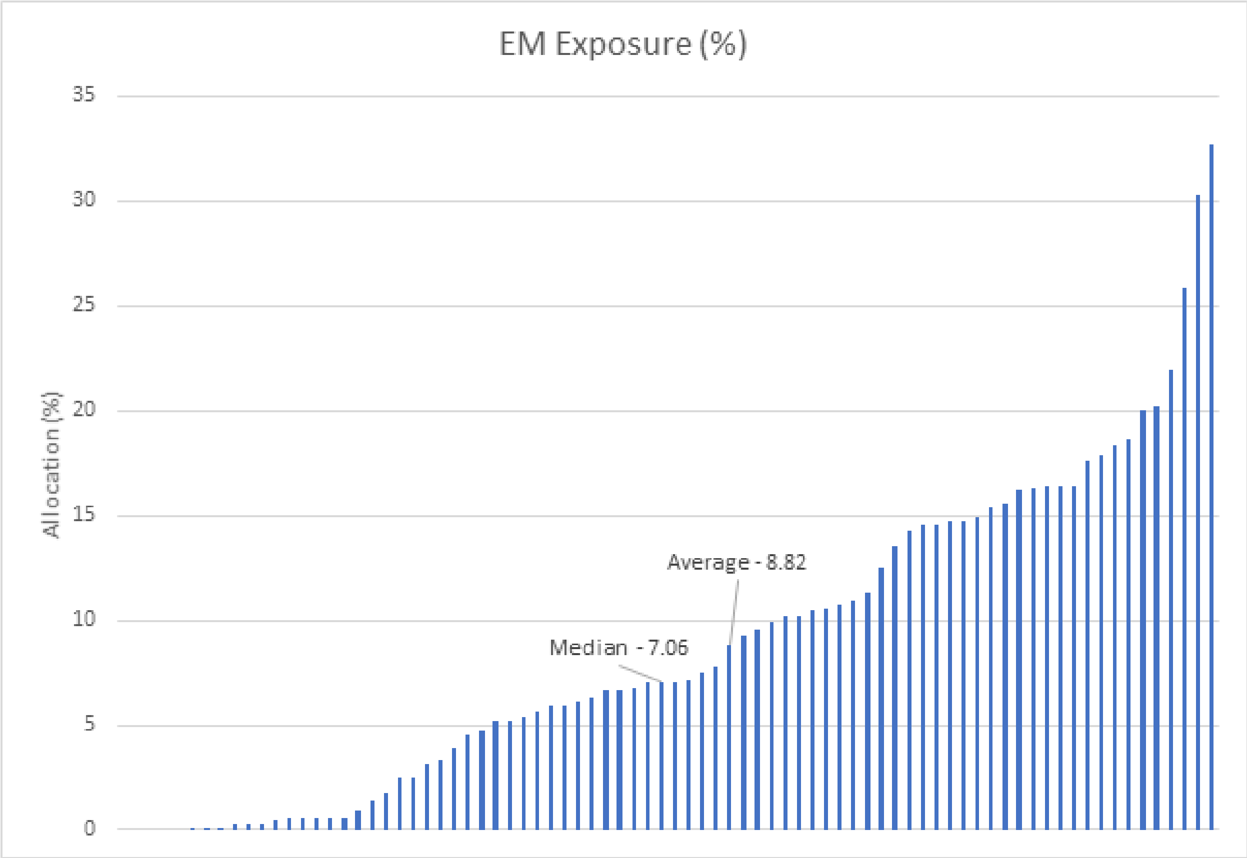
Appendix

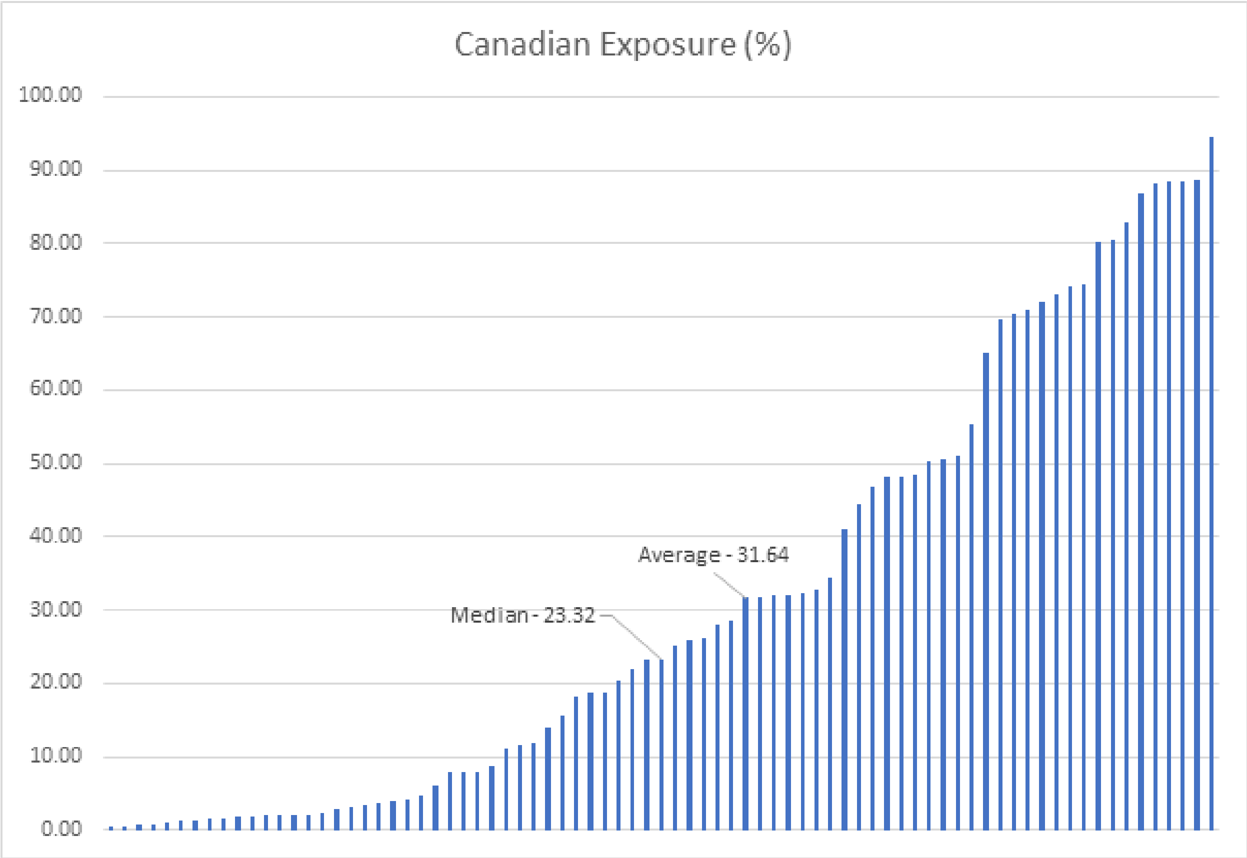
Exhibit 1

Wide range of risk profiles in the proposed list of movers: The 3-year standard deviation for the proposed list ranges from low 3's to mid-11's, with a median of 6. This spans three risk rating classifications based on CSA risk rating methodology and illustrates difficulty of using the category as proposed for peer comparison.

Supporting Data (Sourced from Morningstar Direct as of 04/30/2022 for funds in Appendix A, where available)




EM Exposure (%)
Allocation (%)
35
30
25
20
15
10
5
0
Average - 8.82
Median - 7.06


Canadian Exposure (%)
100.00
90.00
80.00
70.00
60.00
50.00
40.00
30.00
20.00
10.00
0.00
Average - 31.64
Median - 23.32

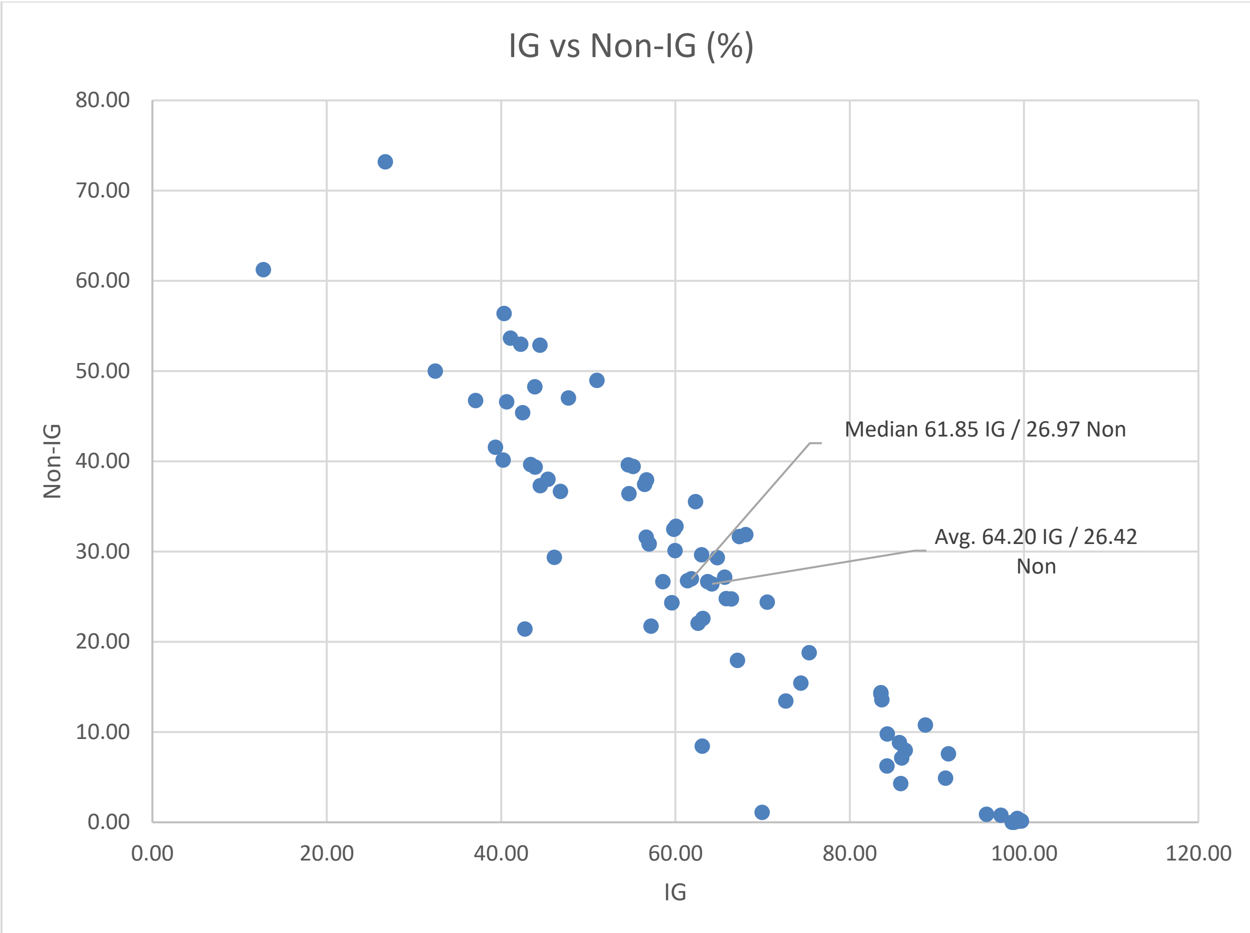

IG vs Non-IG (%)
Non-IG
80.00
70.00
60.00
50.00
40.00
30.00
20.00
10.00
0.00
0.00
20.00
40.00
60.00
80.00
100.00
120.00
IG
Median 61.85 IG / 26.97 Non
Avg. 64.20 IG / 26.42 Non

Exhibit 2

The varying degrees of exposure to High Yield debt and different geographic exposures among the proposed constituents of this category appear to have a material impact on the risk-return profile of the funds. Since these properties are not consistent across the category, the funds composing the category are likely to exhibit divergent characteristics.

To illustrate the extent to which these characteristics can diverge within the proposed category definition, we have provided an example using two of the funds that have been identified for inclusion:

i) RBC Strategic Income Bond Fund

ii) Sun Life Multi-Strategy Bond Fund

Geographic allocation	RBC Strategic Income Bond Fund	Sun Life Multi-Strategy Bond Fund
Emerging Markets	51.9%	
US	28.7%	2.7%
International (ex-EM)	10.6%	
Canada	8.8%	94.9%
All other combined		2.4%
Allocation by Credit Rating		
≥ BBB: 36.9%	36.9%	97.3%
<BBB: 47.6%	47.6%	0.8%
Other: 15.5%	15.5%	
Not Rated		1.9%

As shown, the funds would be grouped in the same category despite material differences in credit quality, and in geographic exposure, investment strategies, and risk/return profiles.

The above is further illustrated by the following correlation matrix calculated by Morningstar for a sample of funds included in the proposed category. As the matrix shows, the Sun Life Multi-Strategy Bond has a very strong correlation with its existing fund category (correlation coefficient of 0.99). The Fund’s correlation with other funds within the new proposed category is often materially lower.

Start Date **3 Years Ago (2019-01-01)** ∨ End Date **Last Quarter End (-1 quarter) (2021-12-31)** ∨ Currency **Canadian Dollar** ∨ **4 More Settings** ∨

	1	2	3	4	5	6	7	8	9
1 Sun Life Multi-Strategy Bond F	1.00								
2 RBC Strategic Income Bond Fund F	0.64	1.00							
3 CI Global Unconstrained Bond Priv Pl F	0.44	0.91	1.00						
4 Fidelity Strategic Income Fund F	0.62	0.72	0.54	1.00					
5 PIMCO Monthly Income F	0.46	0.93	0.95	0.55	1.00				
6 BMO Tactical Global Bond ETF F	0.71	0.54	0.39	0.75	0.39	1.00			
7 Fidelity Multi-Sector Bond Fund F	0.53	0.29	0.02	0.82	0.04	0.70	1.00		
8 NEI Global Total Return Bond Series F	0.61	0.91	0.88	0.58	0.87	0.53	0.17	1.00	
9 Canada Fund Canadian Fixed Income	0.99	0.71	0.53	0.67	0.54	0.74	0.53	0.69	1.00

References:

- https://www.rbcgam.com/en/ca/products/mutual-funds/RBF482/detail
- https://www.sunlifeglobalinvestments.com/en/slgi-funds/sun-life-multi-strategy-bond-fund/mp/SGCBF/curr/CAD/