CIFSC CANADIAN INVESTMENT FUNDS STANDARDS COMMITTEE

March 31st, 2017
Re: CIFSC Category Review Q1, 2017

The CIFSC continuously monitors and analyses the categorization of funds, the current category definitions and structures, as well as any new and developing trends in the investment funds industry. 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. The primary goal of the committee is to help Canadian investors make informed decisions. A description of the review process and timelines can be found in section 1.2, #7 of the CIFSC Policy and Procedures Manual. The CIFSC welcomes feedback at any time through the Contact on the website.

The following is a summary of the proposals considered by the committee, the general feedback on each proposal and ultimately the committee's decision on whether or not to move forward with the proposal.

1. **Proposal:**
   Split the Canadian Focused Equity category into two categories; Canadian Focused Equity and Canadian Diversified Equity to recognize two distinct types of Canadian Equity funds within the current category and improve the purity/homogeneity of the category.

   Proposed Definition: Canadian Focused Equity
   Funds in the Canadian Focused Equity category must invest at least 70% and less than 90% of their equity holdings in securities domiciled in Canada, and their average market capitalization must be greater than the Canadian focused small/mid cap threshold.

   Proposed Definition: Canadian Diversified Equity
   Funds in the Canadian Diversified Equity category must invest at least 50% and less than 70% of their equity holdings in securities domiciled in Canada, and their average market capitalization must be greater than the Canadian focused small/mid cap threshold.

   CIFSC Comments:
   - The committee feels that the name Canadian Diversified Equity is problematic as it could be interpreted in many different ways and doesn't provide a clear indication as to how the funds in the category invest. It was suggested that a more descriptive name would be beneficial to investors. For example, 'Canadian 50-70% Focused' and 'Canadian 70-90% Focused'.
   - In general, the committee feels that adding a Canadian Diversified Equity category does not provide additional benefit to investors and adding the category may increase the level of confusion in terms of overall category schema.

- As an alternative to the proposal above, the committee considered adjusting the parameters on the existing Canadian Focused and North American Equity categories as follows:
  - The Canadian Focused category would change from the current requirements of between 50-90% Canadian equity to between 70-90% Canadian equity while changing the North American Equity thresholds to require the Canada + U.S. content to be greater than 70% and Canadian content to be less than 70%.
- The committee considered several advantages to this proposal including:
  - It would increase the homogeneity of the Canadian Focused Equity category and the Global Equity category without creating a new category.
  - The 70% threshold on Canadian content is consistent with the geographic thresholds on the Canadian Dividend & Income category and the Canadian Balanced categories.

  And several disadvantages including:
  - Decreasing the homogeneity of the North American Equity category.
  - Funds that hold greater than 50% Canadian content and label themselves as 'Canadian' could end up in the North American Equity category.

Outcome:

Ultimately the committee vote was split, resulting in no official proposal at this time. The committee will continue to look at the Canadian Focused, North American and Global Equity categories and potentially make a proposal at the end of Q2 2017.

2. **Proposal:**
   Split the Canadian Short Term Fixed Income category into Canadian Short Term Fixed Income and Canadian Ultra-Short Term Fixed Income categories. Ultra-Short term is frequently considered in other systems (Morningstar US, Thomson Reuter Lipper US, ICI Global).

   Proposed change to Canadian Short Term Fixed Income:
   Same as current only with average duration between 1 and 3.5 years.

   Proposed change to Canadian Ultra-Short Term Fixed Income:
   Same as current only with average duration less than 1 year.

   CIFSC Comments:
   - In general, the CIFSC questions the relevance of the proposed category given the small number of funds that would qualify. There would be 7 confirmed and possibly 10 funds total in the proposed category.
   - The committee also notes that the Ultra-Short term category would overlap with the Canadian Money Market category in terms of risk return profiles.

Outcome:

Ultimately the committee voted overwhelmingly against making a proposal to create a Canadian Ultra-Short Term Fixed Income category.

3. **Proposal:**
Change the threshold on the High Yield Fixed Income category and create a new Multi-Sector Income category to address strategies not meeting the new High Yield category definition.

Proposed High Yield Fixed Income Definition:
Funds in the High Yield Fixed Income category must invest primarily in fixed-income securities with a non-investment-grade credit rating such that in excess of 65% of the portfolio's holdings are invested in high yield fixed income securities (lower than BBB- or equivalent).

Proposed Multi-Sector Income Definition:

Funds in the Multi-Sector Income category seek income by diversifying their assets among several fixed-income sectors, usually investment grade corporate, high-yield, and emerging markets fixed income securities. Funds in the Multi-Sector Income category must hold in excess of 25% and less than or equal to 65% in fixed income securities with a non-investment grade credit rating (lower than BBB- or equivalent). Inclusion in this category may be based on: i) a written asset allocation policy aligning to the above definition (i.e. in a fund's prospectus or written investment policy); ii) a portfolio manager's or sub-adviser's stated or known approach to managing portfolios aligns to the Multi-Sector approach; or iii) the fund's historical asset allocation tendencies.

CIFSC Comments:
- In general, the CIFSC agrees that the High Yield Fixed Income category contains funds with a wide range of investment mandates, all of which happen to meet the current definition for the category. Thus it is necessary to explore different ways to better segment the funds.
- The committee feels the name 'Multi-Sector Income' is problematic as it may lead to confusion with the equity sectors.
- The committee notes that there is currently a clear distinction between the Canadian Fixed Income category and the High Yield Fixed Income category in terms of risk – return profile.
- The committee would like to consider alternatives in terms of segmenting the High Yield Fixed Income category including, but not limited to: emerging markets fixed income, corporate fixed income and tactical or strategic fixed income.

Outcome:

The committee has voted overwhelmingly against proposing a change at this time but unanimously agrees to analyze alternatives for the High Yield Fixed Income category with the goal of making a proposal at the end of Q2 2017.

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