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November 7, 2011

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-1090

Re: **File Number S7-33-11**
Use of Derivatives by Investment Companies under the Investment Company Act of 1940

Dear Ms. Murphy,

On August 31, 2011, the Securities and Exchange Commission ("SEC") issued a concept release requesting comments on issues relevant to the use of derivatives by investment companies ("Funds") registered under the Investment Company Act of 1940 (the "Investment Company Act"), "including potential implications for fund leverage, diversification, exposure to certain securities-related issuers, portfolio concentration, [and] valuation." (the "Concept Release").[1]

Invesco Advisers, Inc. ("Invesco") is a registered investment adviser that, along with its affiliates, provides a comprehensive range of investment strategies through various types of investment vehicles to retail, institutional and high-net-worth clients. As of September 30, 2011, Invesco's Funds totaled approximately $282 billion in assets, including exchange-traded funds. As of that date Invesco, along with our global affiliates, had over $598 billion in total assets under management.

We strongly endorse the ongoing efforts of the SEC to bolster the oversight and risk management of derivatives market participants and recognize the importance of SEC guidance and consistency in the marketplace. The SEC has requested comments broadly related to the application of the Investment Company Act's prohibitions and restrictions on senior securities, and the application of the Investment Company Act to portfolio diversification, concentration and investments in securities-related issuers. We believe these issues must be addressed within the context of a Fund's intended use of derivatives in pursuit of its investment strategy.

[1] *Use of Derivatives by Investment Companies under the Investment Company Act of 1940*, Release No. IC-29776 (Aug. 31, 2011), 76 Fed. Reg. 55237 (September 7, 2011) ("Concept Release").

Once a solid foundation regarding a Fund's use of derivatives within a portfolio is laid, the principles of leverage and segregation and their relationship to traditional tests such as issuer diversification, portfolio concentration, security-related issuer, and counterparty exposure can be addressed in a logical manner consistent with regulatory principles, investor protection goals, and market expectations. We support the recommendations of the Investment Company Institute in their letter dated November 7, 2011 and will take this opportunity to reiterate our position with respect to those recommendations and to identify areas where we believe the industry would benefit from clear guidance from the SEC.[2]

I. Leverage and Asset Segregation

A. Leverage

We agree with the ICI that there is no current universal definition of "leverage" and that Staff guidance in this area will be important in the development of appropriate guidelines concerning the use of derivatives by investment companies.[3] Section 18(d) of the Investment Company Act defines a *Senior Security* as an "obligation or instrument... evidencing indebtedness." As articulated in the Concept Release, there are several distinct types of "leverage" with differing risks.[4] "Indebtedness Leverage" allows for a return on capital in excess of a Fund's investment but also, importantly, creates a potential obligation, or indebtedness, to a third party in excess of the Fund's investment.[5] "Economic Leverage", while allowing for a return on capital in excess of a Fund's investment, does not impose a payment obligation on a Fund above its initial investment.[6] We firmly believe that Section 18 is intended to address Indebtedness Leverage, not Economic Leverage, and would encourage the SEC to provide clear guidance to that effect.

B. Segregation

We support the ICI's recommendation of a principles-based approach to segregation based upon the intended purpose of Section 18, Release 10666[7], Dreyfus[8] and other guidance provided by the Staff. We believe it is appropriate to require Funds to develop policies and procedures based upon an analysis of the characteristics of the instrument they intend to use, the manner in which they will be employed, and how they are to function within the portfolio.[9]

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[2] See letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission regarding Use of Derivatives by Investment Companies under the Investment Company Act of 1940, File Number S7-33-11 (November 7, 2011) ("McMillian Letter").
[3] *McMillian Letter* at 8.
[4] See *Concept Release* at 55240.
[5] See *Concept Release* at n. 31 and accompanying text.
[6] See *Concept Release* at n. 32 and accompanying text.
[7] *Securities Trading Practices of Registered Investment Companies*, Investment Company Act Release No. 10666 (Apr. 18, 1979) ("Release 10666").
[8] See *Dreyfus Strategic Investing & Dreyfus Strategic Income*, SEC No-Action Letter, June 22, 1987 ("*Dreyfus*").
[9] *McMillian Letter* at 11.

i) What is the appropriate amount to segregate?

We believe segregation should relate to a Fund's potential indebtedness. Release 10666 looks at several instruments but in all instances determines that segregation of liquid assets, in an amount equal to a Fund's potential obligation is appropriate.[10] We would expect a Fund's policies and procedures to take into account the precise nature of the exposure associated with each instrument and to adequately assess the potential indebtedness it creates. This analysis should include consideration of the factors outlined by the ICI including the instrument's structure, liquidity, and settlement terms.[11]

ii) What should be segregated?

The type of asset which is segregated has no effect on the amount of leverage a Fund assumes. Historically, the Staff has indicated that any type of liquid asset would be consistent with the purpose and intent of segregation; we agree.[12]

The Staff has also recognized that other appropriate methods exist to "cover" a Fund's potential obligations in lieu of segregation of liquid assets.[13] We believe that there could be many ways to cover a potential obligation arising from the use of a derivative security. Through the use of a principles-based approach designed to fit the degree and manner to which a Fund uses derivatives, each fund complex should design policies and procedures that appropriately address how Funds are able to cover potential obligations associated with derivatives.

iii) How should these assets be segregated?

The Staff determined that Section 18 concerns would not be raised if a Fund covered its obligations by maintaining a segregated account on the books of its custodian bank.[14] The Staff has also indicated that a Fund's assets do not require physical segregation so long as the Fund or the custodian notes on its books that the assets at issue are "segregated".[15] We believe this approach continues to be sound.

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[10] See *Release 10666* at 25132.
[11] *McMillian Letter* at 15.
[12] See *Release 10666* at 25132.
[13] See *Dreyfus*. Also see *Concept Release* at 55243.
[14] See *Release 10666* at 25132.
[15] See *Concept Release* at 55244. See also, "Dear Chief Financial Officer" Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management (pub. Avail. Nov. 7, 1997).

II. Issuer Diversification, Portfolio Concentration, and Securities-Related Issuer Exposure

The Staff has requested comment on the most appropriate way to apply issuer diversification, portfolio concentration and securities-related issuer tests to derivative securities. Specifically, the Staff requested comment regarding how a Fund should value a derivative for purposes of these tests, and whether a Fund should look at the counterparty, the underlying reference asset, or both. We agree with the ICI that these traditional tests should be applied to the underlying reference asset, and not the counterparty.[16]

We believe that, for purposes of these tests, a principles-based approach to determine an instrument's value provides for a thoughtful process in which the "value" of the instrument corresponds to the regulatory intent of the test. For example, if a Fund held a single name credit default swap for the purpose of gaining exposure to the underlying bond, we believe that the notional value of the underlying reference asset would be the appropriate value to use for purposes of these traditional tests. In this case, the Fund's potential Indebtedness Exposure is the notional value of the contract and the purpose of holding the contract is to gain that exposure. In our view, to use the market value of the credit default swap in the application of these tests, in this instance, would not meet the purpose or intent of these tests. In other cases market value would be more appropriate. For example, if a Fund held a long bond in a single name and, at the same time, held an interest rate swap for the purpose of offsetting the interest rate risk associated with that bond the application of notional value would be inappropriate. The interest rate swap, in this case, is not being held for purposes of gaining exposure, would not result in an obligation to the Fund in excess of the market value, and would not affect the Fund's diversification, concentration or exposure to a securities-related issuer.

It is important to note that the examples above are conservative examples designed to ensure compliance with disclosure and regulatory limitations. We would urge the Staff to proceed with caution in developing these guidelines. We believe that a thoughtful approach is required in this process to balance the need to apply these traditional tests with the fact that they may have been designed prior to the introduction of some of the derivative instruments used in today's portfolios. For example, while notional value may, in some instances, represent a Fund's full potential exposure to a particular issuer that exposure is not represented in a Fund's total assets as defined by Rule 5b-1 for section 5 "diversification" testing. For purposes of section 5 diversification testing market value is used. This could lead to skewed results not intended by the Staff. Inconsistencies such as this would need to be worked through carefully with thoughtful consideration and proper guidance provided.

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[16] See *McMillian Letter*.

III. Counterparty Exposure

We also support the ICI's recommendation that counterparty exposure be addressed separately by the Commission pursuant to a separate and new rulemaking initiative.

Counterparty relationships are very different from investment risk and traditional tests as applied to a counterparty do not make sense. We recognize that counterparty exposure has its own discrete issues, many of which did not exist at the time these traditional tests were being developed. This would include the application Title VII of the Dodd-Frank Act[17] and how it is fundamentally changing the way derivatives are traded, cleared, and settled.[18] We support a thoughtful discussion designed to address the issues raised by counterparty exposure and believe the best approach would be through new rulemaking.

We appreciate the opportunity to comment on certain aspects of the Concept Release as they apply to Funds and your consideration of our views.

Sincerely,

John M. Zerr
Senior Vice President

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[17] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
[18] See *McMillian Letter* at 24