Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA NOTICE AND REQUEST FOR COMMENT

CSA MUTUAL FUND RISK CLASSIFICATION METHODOLOGY FOR USE IN FUND FACTS AND ETF FACTS

PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 81-102 *INVESTMENT FUNDS* AND RELATED CONSEQUENTIAL AMENDMENTS

December 10, 2015

Introduction

The Canadian Securities Administrators (**CSA** or **we**) is publishing for a 90-day comment period proposed amendments (**Proposed Amendments**) to:

- National Instrument 81-102 *Investment Funds* (**NI 81-102**);
- National Instrument 81-101 *Mutual Fund Prospectus Disclosure*;
- Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*;
- National Instrument 41-101 *General Prospectus Requirements;*[1] and
- Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements.*[2]

The Proposed Amendments are part of Stage 3 of the CSA's implementation of the point of sale disclosure project (**POS Project**).

The Proposed Amendments mandate a CSA risk classification methodology (the **Proposed Methodology**) for use by the fund manager for the purpose of determining the investment risk level of conventional mutual funds and exchange-traded mutual funds (**ETFs**) (which are collectively referred to as **mutual funds**) for disclosure in the Fund Facts document (**Fund Facts**) as required under Form 81-101F3 *Contents of Fund Facts Document* and in the ETF Facts

[1] As published for comment on June 18, 2015 in "CSA Notice and Request for Comment: Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery - Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements* and to Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements* and Related Consequential Amendments."
[2] See footnote 1.

document (**ETF Facts**) as required under proposed Form 41-101F4 *Information Required in an ETF Facts Document, respectively.*[3]

Currently, the Fund Facts requires a conventional mutual fund to provide its investment risk level based on a risk classification methodology chosen at the fund manager's discretion. We think that a standardized risk classification methodology provides for greater transparency and consistency, which will allow investors to more readily compare the investment risk levels of different mutual funds.

The Proposed Methodology also requires the investment risk level of a conventional mutual fund or an ETF to be determined for each filing of the Fund Facts or ETF Facts, as applicable, and at least annually.

Implementation of this initiative is responsive to comments received throughout the course of the POS Project regarding the need to ensure greater consistency in terms of investment risk level disclosure for mutual funds.

The text of the Proposed Amendments follows this Notice and is available on the websites of members of the CSA.

Background

POS Project

On June 18, 2010, the CSA published CSA Staff Notice 81-319 *Status Report on the Implementation of Point of Sale Disclosure for Mutual Funds*, which outlined the CSA's decision to implement the POS Project in three stages.

Since July 2011, every conventional mutual fund has been required to prepare a Fund Facts for each class and series. Since June 2014, every dealer has been required to deliver the Fund Facts instead of the prospectus in connection with the purchase of mutual fund securities. Following the publication of final amendments to the POS Project for pre-sale delivery on December 11, 2014, dealers will be required to deliver the Fund Facts at or before the point of sale starting May 30, 2016.

As part of the final stage of the POS Project, two concurrent work streams are under way:

1. ETF summary disclosure document and a new delivery model: proposed amendments published for comment on June 18, 2015 would require the filing of an ETF Facts and delivery of the ETF Facts within two days of an investor purchasing securities of an ETF; and

2. CSA mutual fund risk classification methodology: the Proposed Amendments introduce the Proposed Methodology as a standardized risk classification methodology to

[3] See footnote 1.

be applied in determining the investment risk level of conventional mutual funds and ETFs, which are disclosed in the Fund Facts and the ETF Facts, respectively.

CSA Mutual Fund Risk Classification Methodology

Currently, the Fund Facts requires the fund manager of a conventional mutual fund to provide a risk rating for the mutual fund based on a risk classification methodology chosen at the fund manager's discretion. The fund manager also identifies the mutual fund's investment risk level on the scale prescribed in the Fund Facts which is made up of five categories ranging from Low to High.

An earlier version of the Proposed Methodology was published on December 12, 2013 by the CSA in CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the **2013 Proposal**). The 2013 Proposal was developed in response to stakeholder feedback that the CSA has received throughout the implementation of the point of sale disclosure framework for mutual funds, notably that a standardized risk classification methodology proposed by the CSA would be more useful to investors, as it would provide a consistent and comparable basis for measuring the risk of different mutual funds.

A summary of the key themes arising from the 2013 Proposal was published in CSA Staff Notice 81-325 *Status Report on Consultation under CSA Notice 81-324 and Request for Comment on Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (**CSA Staff Notice 81-325**).

Substance and Purpose

By mandating the Fund Facts, and eventually the ETF Facts, we intend to provide investors with the opportunity to make more informed investment decisions, by giving investors access to key information about mutual funds, including the investment risk level, in language they can easily understand.

We think that the introduction of a standardized risk classification methodology will help provide investors with meaningful comparisons between conventional mutual funds and/or ETFs.

The 2013 Proposal

In developing the 2013 Proposal, we reviewed the investment fund risk classification methodology developed by the Investment Funds Institute of Canada (**IFIC**) (**IFIC Methodology**), which is widely used by fund managers in Canada to disclose a conventional mutual fund's investment risk level in the Fund Facts. We also reviewed how other global regulators approached risk disclosure in their summary disclosure documents. We examined the methodology of the Committee of European Securities Regulators (**CESR**)[4] for measuring and disclosing risk in its summary disclosure document, the Key Investor Information Document.

[4] Now the European Securities and Markets Authority (ESMA).

Although standard deviation[5] is used by both IFIC and CESR methodologies, we also examined other risk indicators currently in use and those that could potentially be used to determine and measure risk. We studied 15 indicators, including standard deviation, which can typically be grouped into one of five categories: overall volatility risk measures, tail-related risk measures, relative volatility measures, risk adjusted return measures, and relative risk adjusted return measures.

After a thorough analysis of these 15 indicators, we chose standard deviation as the most suitable risk indicator for the following reasons:

- Its calculation is well known and established;
- The calculation is relatively simple and does not require any sophisticated skills or software;
- It provides a consistent risk evaluation for a broad range of mutual funds;
- It provides a relatively stable but still meaningful evaluation of risk when coupled with an appropriate historical period;
- It is already broadly used in the industry and serves as the basis for the IFIC and CESR methodologies;
- It is available from third party data providers, thereby providing a simple and effective source of data for oversight purposes both by regulators and by market participants (including investors); and
- The implementation costs are expected to be minimal.

We consulted with industry representatives, academics and investor advocates, among others, in Montreal and Toronto in fall 2013. The majority of stakeholders we spoke with supported the development of a standardized, mandatory risk classification methodology, and agreed with the use of standard deviation as the sole risk indicator to determine a mutual fund's investment risk level on the Fund Facts' scale and proposed ETF Facts' scale. Some industry participants pointed out that the fund managers should be allowed some discretion in order to override the quantitative calculation for risk classification purposes.

Feedback on the 2013 Proposal

We received 56 comment letters on the 2013 Proposal. Copies of the comment letters are posted on the website of Autorité des marchés financiers at www.lautorite.qc.ca and the website of the Ontario Securities Commission at www.osc.gov.on.ca. You can find the names of the commenters and a summary of the comments relating to the 2013 Proposal and our responses to those comments in Annex A to this Notice.

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[5] Standard deviation measures how returns vary over time from the average return. It is a measure of volatility of investment returns, i.e., how spread out the returns are from their average, *on average*.

Generally, the majority of commenters supported the development of a standardized, mandatory risk classification methodology, and agreed with the use of standard deviation as the sole risk indicator to determine a mutual fund's investment risk level on the Fund Facts' scale.

Summary of Key Changes to the 2013 Proposal

The following is a summary of the key changes made to the 2013 Proposal.

- **Application of Proposed Methodology to ETFs – s. 15.1.1, NI 81-102**

  In addition to its application to conventional mutual funds, we extended the application of the Proposed Methodology to ETFs.

- **Investment Risk Level – Item 1 of Appendix F, NI 81-102**

  Instead of a six-category scale, we kept the CSA five-category scale currently prescribed in the Fund Facts and proposed ETF Facts. We also changed the standard deviation ranges proposed in the 2013 Proposal, which make them consistent with the standard deviation ranges in the IFIC Methodology.

  In addition, the investment risk level of a mutual fund may be increased if doing so is reasonable in the circumstances.

- **Mutual funds with less than 10 years of history - Item 4 of Appendix F, NI 81-102**

  In the 2013 Proposal, we had a list of criteria for an index to be considered acceptable as a reference index and a list of reference index principles. We removed the list of criteria, but we kept the list of reference index principles and amended it.

- **Fundamental Changes – Item 5 of Appendix F, NI 81-102**

  We added requirements to the Proposed Methodology on how to calculate the standard deviation where there has been a reorganisation or transfer of assets pursuant to paragraphs 5.1(1)(f), (g) or subparagraph (h)(i) of NI 81-102, or where there has been a change to the fundamental investment objectives of a mutual fund pursuant to paragraph 5.1(1)(c) of NI 81-102.

- **Frequency of determining the investment risk level of a mutual fund – s. 15.1.1, NI 81-102**

  We changed the frequency of determining the investment risk level of a mutual fund. Rather than monthly, the investment risk level must now be determined upon the filing of a Fund Facts or ETF Facts and, in any case, at least annually.

- **Records of standard deviation calculation**

  We removed the requirement to maintain records for a ten-year period when using the Proposed Methodology to determine the investment risk level of a mutual fund. The requirement in securities legislation to maintain records for a period of 7 years from the date the record was created applies.[6]

Summary of the Proposed Amendments

Application

The Proposed Amendments apply to conventional mutual funds and ETFs.

Overview of the Proposed Methodology

The Proposed Methodology features are:

<table>
<tr><td>Risk indicator</td><td>10-year (annualized) standard deviation

Note: Calculated on a 10 year historical basis.</td></tr>
<tr><td>Investment risk level and corresponding standard deviation ranges</td><td><table><tr><td>Low</td><td>0 to less than 6</td></tr><tr><td>Low to medium</td><td>6 to less than 11</td></tr><tr><td>Medium</td><td>11 to less than 16</td></tr><tr><td>Medium to high</td><td>16 to less than 20</td></tr><tr><td>High</td><td>20 or greater</td></tr></table>
Note: The investment risk level of a mutual fund may be increased if doing so is reasonable in the circumstances. Adequate records should be maintained to document this increase.</td></tr>
<tr><td>Frequency of determining the investment risk level of a mutual fund</td><td>(a) for each filing of a Fund Facts or ETF Facts; and

(b) at least annually.</td></tr>
</table>

[6] Section 11.6 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

Use of a Reference Index

We propose to allow a reference index as a proxy for conventional mutual funds and ETFs that do not have a sufficient 10-year performance history. We have indicated in the Proposed Methodology that the appropriate reference index should meet, among other things, the following principles:

(a) is made up of one or a composite of several market indices that best reflect the returns and volatility of the mutual fund and the portfolio of the mutual fund;

(b) has returns highly correlated to the returns of the mutual fund;

(c) contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations;

(d) has a historical systemic risk profile highly similar to the mutual fund;

(e) reflects the market sectors in which the mutual fund is investing;

(f) has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets;

(g) is denominated, in or converted into, the same currency as the mutual fund's reported net asset value;

(h) has its returns computed on the same basis (e.g., total return, net of withholding taxes, etc.) as the mutual fund's returns;

(i) is based on an index or indices that are each administered by an organization that is not affiliated with the mutual fund, its manager, portfolio manager or principal distributor, unless the index is widely recognized and used; and

(j) is based on an index or indices that have each been adjusted by its index provider to include the reinvestment of all income and capital gains distributions in additional securities of the mutual fund.

If a reference index is to be used as a proxy, a mutual fund must disclose in the prospectus a brief description of the reference index, and if the reference index is changed, details of when and why the change was made.

The index or indices used in the management report of fund performance (MRFP) in Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* can also be used as a proxy to determine the investment risk level of the mutual fund, if the index or indices meet the principles set out in the Proposed Methodology.

Five-category scale

The Proposed Methodology contemplates keeping the CSA's five-category scale, ranging from Low to High, currently prescribed in the Fund Facts and proposed in the ETF Facts.[7] We note that the standard deviation ranges for the corresponding investment risk levels set out in the Proposed Methodology are consistent with the IFIC Methodology. This approach should minimize the changes in investment risk levels for mutual funds resulting from the implementation of the Proposed Methodology, which was a concern expressed by stakeholders.

Anticipated Costs and Benefits

The Proposed Methodology is responsive to comments we received throughout the course of the POS Project regarding the need for a standard risk classification methodology to be used in the Fund Facts. We think that the development of the Proposed Methodology would benefit both investors and the market participants by providing:

- a standard risk classification methodology across all conventional mutual funds for use in the Fund Facts and all ETFs for use in the proposed ETF Facts;[8]
- consistency and improved comparability between conventional mutual funds and/or ETFs; and
- enhance transparency by enabling third parties to independently verify the risk rating disclosure of a conventional mutual fund in the Fund Facts or an ETF in the ETF Facts.

We further think that the costs of complying with the Proposed Methodology will be minimal since most fund managers already use standard deviation to determine, in whole or in part, a conventional mutual fund's investment risk level on the scale prescribed in the Fund Facts. In addition, as risk disclosure changes in the Fund Facts or ETF Facts between renewal dates are expected to occur infrequently, the costs involved would be insignificant.

Overall, we think the potential benefits of improved comparability of the investment risk levels disclosed in the Fund Facts and ETF Facts for investors, as well as enhanced transparency to the market, are proportionate to the costs of complying with the Proposed Methodology.

Transition

Subject to the rule approval process, we anticipate publishing final rules aimed at implementing the Proposed Amendments in the fall of 2016 (**Publication Date**). We anticipate the Proposed Amendments will be proclaimed into force three months after the Publication Date (**In Force Date**). After the In Force Date, the investment risk level of conventional mutual funds and exchange-traded mutual funds must be determined by using the Proposed Methodology for each filing of a Fund Facts or ETF Facts, and at least annually.

[7] See footnote 1.
[8] See footnote 1.

Local Matters

Annex G to this Notice is being published in any local jurisdiction that is making related changes to local securities legislation, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Some jurisdictions may require amendments to local securities legislation, in order to implement the Proposed Amendments. If statutory amendments are necessary in a jurisdiction, these changes will be initiated and published by the local provincial or territorial government.

Unpublished Materials

In developing the Proposed Amendments, we have not relied on any significant unpublished study, report or other written materials.

Request for Comments

We welcome your comments on the Proposed Amendments. To allow for sufficient review, we are providing you with 90 days to comment.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period.

Deadline for Comments

Please submit your comments in writing on or before March 9, 2016. If you are not sending your comments by e-mail, please send a CD containing the submissions (in Microsoft Word format).

Where to Send Your Comments

Address your submission to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA members.

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Contents of Annexes

The text of the Amendments is contained in the following annexes to this Notice and is available on the websites of members of the CSA:

Annex A – Summary of Public Comments on the 2013 Proposal

Annex B – Proposed Amendments to National Instrument 81-102 *Investment Funds*

Annex C – Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

Annex D – Proposed Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

Annex E – Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements*

Annex F – Proposed Changes to Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements*

Annex G – Local Matters

Questions

Please refer your questions to any of the following:

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ANNEX A

SUMMARY OF PUBLIC COMMENTS AND CSA RESPONSES ON CSA NOTICE 81-324 AND REQUEST FOR COMMENT PROPOSED CSA MUTUAL FUND RISK CLASSIFICATION METHODOLOGY FOR USE IN FUND FACTS

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Part I – Background

Summary of Comments

On December 12, 2013, the Canadian Securities Administrators (the **CSA** or **we**) published CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (**CSA Notice 81-324**) which proposed a standardized risk classification methodology for use in the Fund Facts. The text of the CSA risk classification methodology (the **2013 Proposal**) is contained in Annex A to CSA Notice 81-324.

The comment period expired on March 12, 2014. We received submissions from 56 commenters and the commenters are listed in Part V of this document. This document only contains a summary of the comments received on the 2013 Proposal and the CSA's responses. We received comments on disclosure items in the Fund Facts but we are not considering any additional disclosure items at this time. Comments received on the 2013 Proposal have informed the development of our current proposal (the **Proposed Methodology**). We wish to thank everyone who took the time to prepare and submit comment letters.

Part II - Comments on the 2013 Proposal

Issue	**Comments**	**Responses**
General comments	Many commenters provided broad support for the CSA's efforts in developing a standardized risk classification methodology, including the objectives and principles set out in the 2013 Proposal.	We thank all commenters for their feedback. We are proceeding with the Proposed Methodology with proposed rule amendments aimed at implementing the Proposed Methodology for use by conventional mutual funds in the Fund Facts and exchange-traded mutual funds (**ETF**s, together with conventional mutual funds, **mutual funds**) in the proposed ETF Facts.[1]
	One commenter, The Investment Funds Institute of Canada (**IFIC**), acknowledged that although the risk classification methodology developed by IFIC (the **IFIC Methodology**) was developed only for IFIC's members, they supported making it publicly available for use by non-members as well.	From our research, we know that the IFIC Methodology is the predominant risk classification methodology currently used by fund managers. Our Proposed Methodology was informed by the feedback we received on the 2013 Proposal. We note that the Proposed Methodology is consistent with the IFIC Methodology in many respects, including the use of standard deviation (**SD**) as a risk measure, a five-band risk scale, and the SD ranges for the risk bands. We believe this should minimize the changes in investment

[1] See CSA Notice and Request for Comment: *Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery* as published on June 18, 2015.

		risk levels for funds resulting from the implementation of the Proposed Methodology.

Part III - Issues for comment

Issue	**Comments**	**Responses**
1. As a threshold question, should the CSA proceed with (i) mandating the 2013 Proposal or (ii) adopting the 2013 Proposal only as guidance for IFMs to identify the mutual fund's risk level on the prescribed scale in the Fund Facts? **Are there other means of achieving the same objective than by mandating the 2013 Proposal, or by adopting it only as guidance?** **We request feedback from IFMs and dealers on what a reasonable transition period would be for this.**	Several commenters emphasized that any risk classification methodology developed by the CSA should be mandated so that investors can readily compare funds knowing that the investment risk levels of mutual funds are determined using a standardized risk classification methodology. One commenter noted that this would assist investors in making informed investment decisions. One commenter believed that requiring the adoption of a more objective and uniformly applied metric such as SD will help reduce and eliminate "arbitrage" whereby some fund managers may determine the investment risk level by using subjective factors and giving a product a lower rating than it may otherwise warrant based on a more objective assessment.	The CSA have decided to move forward with a mandated standardized methodology. In addition to written comments received, the majority of experts we consulted with in Fall 2013 also recommended the use of a standardized risk classification methodology in order to level the playing field between mutual funds, and to eliminate arbitrage. Adopting a standardized risk classification methodology would achieve the objective of comparability across asset classes and mutual fund products.

	While supporting a risk classification methodology prescribed by the CSA, one commenter suggested that where the chosen standard is impractical to implement or when it would lead to meaningless or misleading results, exemption requests should be considered by the CSA.	
	Several commenters also commented that it is beneficial for Canadians to have all mutual funds evaluated on a consistent standard. However, these commenters recommended that the CSA consider adopting the current IFIC Methodology as the new mandatory standard. This would accomplish the CSA goal of ensuring consistent determination of investment risk levels across all mutual funds and also have a limited impact on existing Canadian investors and the industry. This would enable a shorter transition period.	As mentioned above, the 2013 Proposal has several features that are consistent with the IFIC Methodology, including the break points for the various risk bands. We expect that this will help reduce any transition period following the implementation of the Proposed Methodology. We note that the IFIC Methodology, as currently constructed, allows for significant use of discretion by fund managers and has not been consistently applied by fund managers in rating their mutual funds.
	Two commenters suggested that the IFIC Methodology is widely used by the vast majority of the industry and is easily understood by investors, and therefore, the IFIC Methodology should be adopted to minimize any impact on investors.	
	Along the same lines, one commenter suggested that the CSA rule should	

	mandate use of a single methodology which is managed by an industry group with appropriate knowledge and experience to meet the objectives (expanded to include investor interest) as set out in the CSA proposal. The commenter believed that management of guidance relating to the IFIC Methodology through IFIC's Fund Risk Classification Task Force could be expanded to include representatives from different industry segments, with the CSA as observers when the methodology itself is discussed annually.	
	One commenter urged the CSA to consider the Committee of European Securities Regulators (**CESR**), now European Securities and Markets Authority (**ESMA**), risk classification methodology for adoption in Canada.	In developing the 2013 Proposal, the CSA analyzed and considered both the IFIC and CESR methodologies. The 2013 Proposal has been amended based on the feedback received and, we believe, best fits the criteria and objectives as outlined in it. It should be noted that the European summary document and risk scale have significant differences compared to our summary documents. In our view, the Proposed Methodology best reflects the reality of our mutual fund market which allows for comparability across mutual funds.
	Several commenters believed that the CSA should adopt high level principle-based guidance with respect to risk	The CSA believes that a standardized risk classification methodology is needed to enable investors to make meaningful

	classification rather than mandate the 2013 Proposal. In one commenter's view, if the risk rating is not subject to fund manager discretion then it should only be guidance. One commenter did not recommend adopting the 2013 Proposal as guidance for fund managers, as it would co-exist with the currently used IFIC methodology, leading to non-comparability of information in the Fund Facts.	comparison between mutual funds. We believe that a standardized risk classification methodology will benefit all mutual funds with greater transparency and consistency. It is our view that high-level principle-based guidance could not achieve either of these objectives, as it would allow room for potential manipulation.
2. We seek feedback on whether the 2013 Proposal could be used in similar documents to Fund Facts for other types of publicly-offered investment funds, particularly ETFs. **For ETFs, what, if any, adjustments would we need to make to the 2013 Proposal?** **For instance should standard deviation be calculated with returns based on market price or net asset value per unit?**	Several commenters were of the view that the same risk classification methodology should apply to all investment funds to ensure a level-playing field for all products. Some commenters asked how alternative funds, closed end funds, leveraged ETFs or structured products' risk rating would be determined. These commenters questioned that if these non-mutual fund products come out as high risk from a volatility perspective, would comparisons by retail investors be meaningful or misleading? These commenters question whether volatility alone is a sufficient	We are proposing that the Proposed Methodology be used both for exchange-traded mutual funds and conventional mutual funds. We note that alternative funds, closed end funds and structured products are not currently required to produce a Fund Facts or an ETF Facts, and therefore, are not required to determine their investment risk level. Therefore, the Proposed Methodology will not apply to such products. Should the disclosure requirements for these non-mutual fund products change, the CSA would consider

	measure of risk for these types of products. There may be high-risk mutual funds that are significantly less risky than a high-risk closed-end fund or alternative fund but this may not be apparent, if they are all bunched in the same risk category. Some commenters suggested that the limitations of volatility risk will likely become evident when trying to expand summary disclosure to other types of funds.	the applicability of the Proposed Methodology to such products.
	Several commenters favoured using market price data rather than net asset value (**NAV**) in calculating SD for ETFs since it is more reflective of the returns investors are likely to realize	The CSA conducted research on this issue to assess whether there are significant differences in the investment risk level of a mutual fund if market values are used versus NAV. While a very small minority of ETFs provided a different risk rating by using market value versus NAV, we note that the larger issue the CSA encountered was consistent availability of market values for thinly traded ETFs or for the advisor series of ETFs. Given the lack of consistent market value data for ETFs, the CSA are proposing that NAV be used to determine investment risk level.
	Two commenters submitted that whether SD is best measured based on market price or NAV would be best determined by a focussed investigation. One of these commenters urged the CSA to include ETFs in the study before publishing any	Using NAV to determine investment risk level also allows for consistency with performance reporting and continuous disclosure requirements for mutual funds.

	proposals.	
3. We seek feedback on whether you agree or disagree with our perspective of the benefits of having a standard methodology, as well as whether you agree or disagree with our perspective on the cost of implementing the 2013 Proposal.	The vast majority of commenters who answered this question agreed with the CSA's perspective on the benefits of having a standard risk classification methodology as it will provide consistency and transparency of disclosure and improved comparability of different mutual funds. Some commenters estimated that many fund managers will have a significantly high percentage of their mutual funds moving to a higher risk classification under the 2013 Proposal, resulting in significant impact for dealers and investors. Two commenters added that the cost to fund managers and dealers would be minimized if the IFIC Methodology is adopted since most firms already calculate and review the risk associated with their product in accordance with this methodology. A few commenters who agreed with the benefits of having a standardized risk classification methodology suggested that the cost incurred by fund managers is not expected to be significant if current risk categories and risk band breakpoints are	We agree that a standardized risk classification methodology will enhance transparency and ensure comparability between mutual funds. We have made a number of changes to the 2013 Proposal specifically in response to the comments received regarding the impact on dealers. We have retained the five-category risk scale currently used in the Fund Facts, used SD as the risk indicator and our proposed risk band break points are consistent with those used by the IFIC Methodology. We believe these changes to the 2013 Proposal will minimize the cost of implementation for both fund managers and dealers.

	not changed. This is because dealers would not have to amend their processes and systems technology to accommodate changes. Changes in the risk classification of funds, however, would require dealers to conduct client account reviews, re-paper client accounts and/or change client portfolio allocations.	
4. We do not currently propose to allow fund IFMs discretion to override the quantitative calculation for risk classification purposes. Do you agree with this approach? **Should we allow discretion for IFMs to move their risk classification higher only?**	Several commenters agreed that fund managers should not be allowed to override the quantitative calculation for risk classification purposes. Two of these commenters suggested that if only a quantitative metric is used to determine the investment risk level, the CSA should allow fund managers discretion to move their risk classification higher only. A few commenters explained that not allowing the use of qualitative factors for the purposes of determining investment risk levels was advantageous as discretion can lead to misleading ratings and defeat the goal of comparability and transparency. One commenter added that if truly extraordinary circumstances prevail, some explanatory disclosure should be allowed.	After considering the comments received, the CSA recognize that circumstances could give rise to the need for consideration of qualitative factors in addition to the quantitative calculation in determining the investment risk levels of mutual funds. Therefore, the Proposed Methodology contemplates the use of discretion to classify a mutual fund at a higher investment risk level. However, the CSA are of the view that there should be no discretion to classify a mutual fund into a lower investment risk level. We consider that a mutual fund should be classified, at a minimum, at the investment risk level determined by its SD.

	Several commenters were of the view that other types of risk, both measurable and non-measurable, may exist. The commenters believed fund managers must retain their discretionary power to classify an investment fund either higher or lower than the risk classification indicated by quantitative results. Doing so allows a fund manager to make full, true and plain disclosure of all material facts relating to the investment funds being offered. By removing discretion completely, the 2013 Proposal removes the responsibility of fund managers to consider other factors that could affect the risk of a fund, and thus reduces the responsibility to disclose all risks. One of the commenters added that the prospectus and Fund Facts impose civil liability so it is crucial that a fund manager is comfortable with the investment risk level assigned to a particular fund. Some commenters believed that a fund manager can document the reasons for deviating from the numerical SD calculation where they do so. One commenter supported the inclusion of a qualitative element which could be monitored by a third party, in conjunction with industry input and participation. Another commenter told us that it was	

	important that fund managers be provided with discretion when determining the investment risk classification of funds in order to maintain consistency year over year. The commenter added that fund managers should be prepared to defend their use of discretion if it is questioned by the CSA.	
5. Keeping the criteria outlined in the introduction above in mind, would you recommend other risk indicators? **If yes, please explain and supplement your recommendations with data/analysis wherever possible.**	Approximately two thirds of the commenters agreed with the use of SD as a comparable measure of risk for the purposes of a risk classification methodology. SD's simplicity, objectivity and relevance in measuring volatility risk are shared by the commenters. Its applicability to a large range of funds was also commended. While commenters generally supported the use of SD, some remained concerned with over-simplifying mutual fund risk to a single, quantitative measure. The commenters suggested that when asked about risk, many investors indicate their greatest concern is the risk of loss of capital, which is not captured by SD.	The CSA propose to keep SD, which measures volatility of past returns of the mutual fund, as the risk indicator for the Proposal Methodology. We are of the view that given the available alternatives and the known data obstacles, SD is still the best general risk indicator and one that is useful as a first test to measure overall risk. Our analysis of data from the Canadian fund marketplace revealed that there were relatively few cases where alternative risk indicators signaled a higher risk rating than that indicated by SD. We also note that most risk indicators will tend to underestimate risk where the probability of event risk (i.e. unforeseen event) is high. Before the CSA decided on SD as its preferred risk indicator, we conducted a thorough study of 15 other indicators. The other indicators studied included, among others, risk/return indicators, (such as the Sharpe Ratio, the Information Ratio and the Sortino ratio), tail risk indicators (such

		as Value at Risk (**VAR**), CVAR) and performance indicators (such as worst period). Our study included an assessment of how well each of these indicators met our principles for the development of the Proposed Methodology. Further, we also assessed if any of these indicators added further value as a secondary indicator in addition to using SD as a primary indicator. To perform this analysis, we looked at data from mutual funds that were available in Canada from 1985 to 2013. We noted that these indicators tended to have significant correlation with SD. In other words, if VAR, as an example, indicated high risk for a particular fund, SD would have a similar higher risk indication. In only a small minority of instances (less than 2%) did SD tend to underestimate risk relative to another indicator such as VAR. Even in such instances, these funds tended to be small/mid cap equity and resource/precious metals equity funds, which already tend to be classified in the Medium to High or High risk category based on the SD calculation. We, therefore, concluded that SD did as good a job as any other indicator, and the additional complexity and regulatory burden associated with adding a secondary indicator was not justified.
	A few commenters opposed the use of	Since the creation of the Fund Facts, SD

	SD as an indicator of risk disclosure in the Fund Facts. They felt that SD is not easily understood in practical terms by most retail investors. They wondered if retail investors will understand that a fund with a high SD does not necessarily mean that such a fund is worse than another with a low SD. Several commenters believed that SD requires some knowledge of mathematical statistics to be employed effectively for informed decision making. Such approach is much too complex to be used by retail investors, no matter how well described in plain language. Another commenter was concerned that SD is an insufficient, inappropriate and not well-understood measure of risk. Additional descriptions of risk exist and are preferable as they propose a table/graph of worst-case and best-case historical return scenarios that can be used to demonstrate fund volatility. According to this commenter, the Fund Facts' disclosure of volatility is presented and used as though it gives an indication or assurance of future variability/risk. The commenter encouraged the CSA to do exhaustive cognitive and behavioural testing to determine what patterns of variation a risk-averse investor would	has been widely used to determine the investment risk level of a mutual fund on the risk scale in the Fund Facts. While investors may not be able to understand the mathematical calculation of SD, there is a plain language description of volatility in the Fund Facts. The investment risk level, along with other key information in the Fund Facts, such as the suitability section will help investors make an informed investment decision. Further, in the Fund Facts, under the risk scale, there is a cross reference to the Risk section of the mutual fund's simplified prospectus for more information on risks. The CSA disagrees with the commenter. Past volatility is not presented in the Fund Facts as being an assurance of future variability. Under the section "*How risky is it?*" in the Fund Facts, it states "*This rating is based on how much the fund's returns have changed from year to year. <u>It doesn't tell you how volatile the fund will be in the future. The rating can change over time. A fund with a low risk rating can still lose money</u>*." Under the same section, there is a cross reference to the Risk section of the mutual fund's simplified prospectus for more information about the risk rating and

	view as risky before finalizing the statistical models, the classifications and the ranges that have been proposed. In the commenter's opinion, investors understand risk in terms of potential dollar losses in their portfolio more easily than percentage returns. In the commenter's experience most investors can understand graphs and tables far more readily than calculations such as SD. According to one commenter, SD on its own does not tell us anything about the uncertainty of price movements (be it their size or their probability of occurring) or the uncertainty of events surrounding price movements, or whether it is a good or a bad risk to assume. Therefore relying on SD as the sole information point about risk does not inform the investor about the actual range and impact of outcomes that could affect them.	specific risks that can affect the mutual fund's returns.
	Two commenters were of the view that looking at volatility risk alone can be misleading and lead to sub-optimal decisions for the investor. As a result, some risk/return metric disclosure should be added as a supplement to any type of risk disclosure. Metrics such as Sharpe ratio and Information ratio would provide	Please see response above which describes the CSA's analysis in regard to consideration of other metrics.

	additional clarity to how effectively fund managers use risk and how consistent their returns are. These commenters added that the Sharpe ratio and the Sortino ratio are far more meaningful as they measure risk adjusted returns. The Sharpe ratio allows an investor the ability to quantify an investment's risk relative to its investment performance in order to decide if a financial product is worth the risk. One of these commenters noted that the Sortino ratio is a more meaningful measure of investment risk than SD as the Sortino ratio is similar to the Sharpe ratio, but its denominator focuses solely on downside volatility, not overall volatility. It is only downside volatility that is relevant and unwanted. This is a serious flaw in the calculation of both SD and the Sharpe ratio as a measure of risk. The Sortino ratio is a more meaningful measure of investment risk than SD. The commenter recommended that investment risk levels be measured based on portfolio holdings, thus reflecting the inherent risks. Should the CSA proceed with mandating a standardized risk classification methodology, the commenter strongly recommended that it be based on a blend of measures that includes Conditional Value at Risk (**CVAR**) and a holdings-based approach.	 Please see response above which describes the CSA's analysis in regard to consideration of other metrics.

	The commenter believed that the use of the SD measure as the sole measure of risk does not serve the best interests of the investors.	
6. We believe that standard deviation can be applied to a range of fund types (asset class exposures, fund structures, manager strategies, etc.). **Keeping the criteria outlined in the introduction above in mind, would you recommend a different Volatility Risk measure for any specific fund products?** **Please supplement your recommendations with data/analysis wherever possible.**	Several commenters agreed that a uniform measure should be applied across all investment funds. Two commenters submitted that given the structured nature of target date funds, balanced funds and T-class series of securities, a different approach to articulating risk is required for these types of funds. In regard to target date funds, commenters indicated that one of the associated risks is a premature movement to a safe mode (a "triggering event") which happened in 2008 - such a risk is not captured by SD. Further, life cycle funds are designed such that their risk level changes over time, so a backward looking risk measure may not be a suitable indicator of product risk as it may overstate the risk of the fund at a point in time.	We thank commenters for their feedback. In order to address concerns relating to overstatement of investment risk levels for target date funds, we performed an analysis of the volatility profile of current target date funds. The analysis demonstrated that target date funds closer to their target date did indeed have lower SD, however, the difference in SD over the life cycle of target date funds was relatively small owing primarily to the inherent diversification attributes of products. Thus, we expect that many target date funds will remain in the same risk band over the course of their existence and those that do shift will not shift by more than one risk band, and even then very slowly. Therefore, the CSA did not propose a

		change to the Proposed Methodology since overstatement of risk for target date funds was not supported by the data studied.
	In regard to balanced funds, commenters noted that constant changing of asset mix can be a challenge in regard to risk classification. Similarly, some commenters pointed to tactical asset allocation funds as a challenge for the proposed risk classification methodology since the underlying statistical distribution is constantly changing for such funds.	For balanced funds and T-series of securities, the 2013 Proposal allows for discretion to use a reference index as a proxy for missing information that best fits the risk profile of such funds. The reference index can be a single index or a blend of indices that best fits the risk profile, and therefore, should allow an index to be customized to the risk profile of the fund.
	Similarly, commenters also pointed to T-series of securities that return capital each month, suggesting that finding an appropriate index for the purposes of backfilling information may be difficult. Further, such mutual funds run the risk of disintegration if payouts are too steep, and such a risk is not captured by SD. Commenters also suggested that currency hedged funds complicate return distribution profile and fund behavior/volatility, thus a different approach may be needed for currency hedged funds, such as a separate SD calculation for the hedged and unhedged series of a mutual fund.	The Proposed Methodology requires that the investment risk level of a mutual fund be determined by using the oldest series of the mutual fund, *unless* the oldest series has a different profile or materially different terms associated with it. As such, where appropriate, the investment risk level of currency hedged series of a mutual fund should be determined separately if it is materially different to the other series of the mutual fund.
	One commenter noted that ETFs and	As noted above, we are proposing that the

	exempt funds by their nature are different products. The commenter supported investigating the possibility of using a different volatility risk measure for specific fund products. One commenter agreed that a risk classification methodology that is based on SD of fund returns is a good measure of a fund's risk. However, fund managers should have the flexibility to supplement SD with other measures that may be more tailored to the specific fund. A good measure for a fixed income fund, for example, would be duration, which is a measure of sensitivity to interest rate risk, added this commenter. Another possible measure, for a fund that uses derivatives particularly, would be VAR.	Proposed Methodology be used both for exchange-traded mutual funds and conventional mutual funds. Please refer to our responses under question #5 in regard to applicability of other risk measures in addition to SD.
7. We understand that it is industry practice (for IFMs and third party data providers) to use monthly returns to calculate standard deviation. Keeping the criteria outlined in the introduction above in mind, would you suggest that an alternative frequency be used? **Please specifically state how a different**	Commenters agreed that using a mutual fund's monthly returns is appropriate. Commenters added that monthly data is traditionally used to assess risk and return data in the mutual fund industry.	Given the feedback from commenters, the CSA are keeping the monthly returns with reinvestment of all income and capital gains distributions for the Proposed Methodology.

frequency would improve fund risk disclosure and be of benefit to investors. **Please supplement your recommendations with data/analysis wherever possible.**		
8. Keeping the criteria outlined in the introduction above in mind, should we consider a different time period than the proposed 10 year period as the basis for risk rating disclosure? **Please explain your reasoning and supplement your recommendations with data/analysis wherever possible.**	Several commenters agreed with the proposed 10 year period as the basis for risk rating disclosure. One commenter added that a 10 year period has the effect of attenuating sudden changes in financial markets and helps smooth out extreme fluctuations which are often temporary. Although one commenter supported the use of longer-term performance data to calculate SD, the commenter suggested that this be modified to 10 years or as far back as required to include at least one bear market for the mutual fund or its relevant benchmark. One commenter agreed with the proposed 10 year period as the basis for comparison of SD across mutual funds. However, the commenter was of the view that a 10-year period would be insufficient for measuring risk of loss. There are long periods of time where capital markets have delivered strong performance with limited downside.	After reviewing fund data for the Canadian fund marketplace, we are of the view that the use of ten-year performance returns is preferable to both shorter (3, 5, 7 years) and longer time periods (15, 20, 25 years) as it strikes a reasonable balance between indicator stability and data availability. We also note that the CSA studied data of available mutual funds and various indices using varying time periods ranging from three, five, seven, ten and fifteen years for the calculation of the SD. We noted that three, five and seven year SD results caused frequent risk band changes for a number of funds resulting in significant costs for fund manufacturers as well as dealers. Compared to such time periods, a 10 year SD calculation was a more stable indicator of risk. We note that moving from a 10 year SD calculation to a 15 year SD calculation only provided minimally increased stability as a risk indicator, and any benefits from moving to a time period longer than 10 years would be offset by the

	While a rolling 10-year measurement period will not significantly impact the SD calculation, it could significantly impact the worst and best returns. For risk of loss to be a stable indicator, it requires a static start date, with as long a time period as possible (for example, starting from 1960).	costs of gathering data for a longer time period. We also note that a 10 year time period typically tends to catch at least one downturn in economic and financial markets.
	Some commenters disagreed with the use of a 10 year time period for the purposes of the SD calculation. One commenter noted that the average lifespan of a mutual fund is less than 6 years, while studies indicate that the average holding period of a mutual fund is less than 5 years and shrinking. This indicates that a typical investor will not experience the smooth, consistent ride that a 10 year SD implies, but will experience the swings in volatility that occurs over a 5 year period. The commenter conceded that using the 10 year period will ensure that mutual funds are not frequently switching risk categories.	In regard to comments about the average life of a mutual fund and the average holding period of a mutual fund, we note that the investment risk level is intended to capture the volatility risk of a particular mutual fund and a particular asset class rather than providing an assessment of the risk profile of an average mutual fund investor.
	One commenter felt that the use of a 3-year annualized SD model would decrease the ability of funds to obfuscate their risk rating and allow for better comparability across all mutual funds, as more funds would possess this complete return history. Another commenter	

	suggested that the CSA should consider whether it is better to use a 7-year SD if this presents fewer incidences of needing to use a reference index as a proxy and will, therefore, be subject to less manipulation. One commenter thought that using a 10-year history to calculate the SD for an investment fund may result in an investment fund being classified as more volatile than it actually is if there are two volatile periods i.e. at the beginning and at the end of the 10 years. The commenter believed that using three-to-five-year historical data would be the appropriate timeframe as this represents the average time that an investor holds securities of an investment fund. Several commenters did not believe that a 10-year annualized SD provides any more information than the 3 or 5 year annualized SD presently prescribed under the IFIC methodology. These commenters recommended adopting 3 or 5 year annualized SD similar to the IFIC Methodology. To the best of another commenter's knowledge there is no research indicating that 10 years is a better indicator of a market cycle versus 5 years or 15 years,	

	other than that the longer periods smooth results. One commenter noted that requiring the presentation of a 10 year measure of volatility (real or simulated) is contrary to the CFA Institute's Global Investment Performance Standards (**GIPS**). The commenter suggested that rather than selecting one risk category for a fund, the volatility of the fund be presented over time in graph format by showing, for each period, the annualized three year SD. This commenter recommended shortening the period to 5 years, similar to the CESR Guideline.	 We note that the purpose of the GIPS presentation is entirely different from the purposes of presentation of risk classification level in the Fund Facts or ETF Facts. GIPS performance presentation aims to ensure fair presentation of investment performance results of money managers, rather than an assessment of the risk level of their portfolios.
9. Keeping the criteria outlined in the introduction above in mind, should we consider an alternative approach to the calculation by series/class? **Please supplement your recommendations with data/analysis wherever possible.**	A few commenters agreed that a consistent approach should be applied across all series/class of a mutual fund. One commenter did not believe that it is necessary to apply the 2013 Proposal to individual series/classes of a mutual fund. Each series/class of a mutual fund has identical fund holdings and therefore bears equivalent levels of risk. While it is true that returns vary by series/class, differences in SD are slight to non-existent. Several commenters submitted that the fund manager should use the total returns of the "oldest" mutual fund series/classes	Our analysis concluded that the variance of the SD calculation is small across series/classes of securities of the same mutual fund. For this reason, and after considering the comments received, we are not requiring that the investment risk level be determined for each series/class of securities of a mutual fund, unless a series/class of securities possesses an attribute that could result in a different investment risk level than that of the mutual fund. In such instances, the investment risk level should be determined for that particular series/class of securities. An example of such an instance would be a currency hedged series/class of securities of a mutual fund which could have

	as the basis for his/her volatility risk calculation across all the mutual fund series/classes having the same strategy as the volatility risk remains the same. Two of these commenters added that this should be the case unless an attribute of a particular fund series/class would result in a materially different level of volatility risk (e.g. currency hedging), in which case, the total returns of that particular mutual fund series/class must be used. One commenter told us that risk should be calculated and reported separately for different series of a mutual fund's units (for example, D and F class series) given that the greater the fees, the greater the risk of loss while SD does not change.	materially different performance returns relative to the other series of the mutual fund which may result in a different investment risk level.
10. Keeping the criteria outlined in the introduction above in mind, do you agree with the criteria we have proposed for the use of a reference index for funds that do not have sufficient historical performance data? **Are there any other factors we should take into account when selecting a reference index?** **Please supplement your recommendations with data/analysis wherever possible.**	A few commenters agreed with the use of a reference index in the absence of sufficient historical statistical information. One commenter not only agreed with the use of a reference index for the purpose of backfilling missing data but suggested that funds that have a 10 year history should provide data corresponding to a reference index similar to their funds. In so doing, investors could compare a fund's volatility with the volatility of its reference index.	The CSA are aware that the majority of mutual funds do not have 10 years history required for the Proposed Methodology. To address this issue, we have proposed the use of a reference index as a proxy for the missing data. The Proposed Methodology sets out criteria for what constitutes an appropriate reference index to be used as a proxy for the purposes of backfilling missing data history.

	One commenter was of the view that using a reference index is not an appropriate method of representing true expected volatility of any mutual fund and may lead to unintended consequences. When the performance of a reference index is compiled with the historical returns of a mutual fund, it does not allow investors to determine if the fund manager's active management style adds to the volatility of the fund or whether that is a function of its reference index. The commenter believed that permitting a fund manager to choose a reference index as a proxy will insert a measure of uncertainty and discretion into the calculation. In order to reduce some of the discretion, the commenter recommended that if use of a reference index as a proxy is permitted, fund managers should also be required to perform the calculation based only on the actual returns of the mutual funds and show that information alongside the reference index, and explain (if there is a difference) how the mutual fund would fit in a different risk band if the actual performance history and not using the reference index as a proxy for the missing returns over a 10 year period. Two commenters suggested that the use of a reference index is contrary to every	The Proposed Methodology requires the selection of a reference index that reasonably approximates the volatility and risk profile of the mutual fund. The Proposed Methodology also sets out criteria for selecting and regularly monitoring the appropriateness of the reference index. We do not propose to add the suggested data points to the Fund Facts at this point as this is only likely to add confusion, in particular, for retail investors. The CSA believe that the use of a reference index data in determining the investment

	other CSA publications, particularly CSA Staff Notice 31-325 *Marketing Practices of Portfolio Managers* issued July 2011 (a successor to OSC Staff Notice 33-729 Marketing Practices of Investment Counsel/Portfolio Managers issued November 2007). In both notices, the use of hypothetical or simulated performance data, especially for retail investors, is basically prohibited. Only actual returns are to be presented. It is also noted that under no circumstances are hypothetical and actual returns to be linked, which the 2013 Proposal specifically requires. The prohibition on hypothetical data is due to the various risks and inherent limitations in using such data, as outlined in the Notices. Consequently, the use of a reference index as a proxy for returns over a 10 year period as if they were achieved by the mutual fund and linking them to actual returns, is contrary to established CSA policy. The generation of a hypothetical or simulated risk profile, utilizing a linkage of theoretical and actual returns, is also prohibited by the CFA Institute GIPS.	risk level of a mutual fund is not contrary to previous CSA publications on the use of hypothetical or simulated performance data. The use of reference index data in the Proposed Methodology is limited to determining the investment risk level of a mutual fund which is disclosed in the Fund Facts or ETF Facts. The reference index is not used as a representation of a mutual fund's performance but rather it acts as a proxy for missing data in determining its investment risk classification using the Proposed Methodology.
	Two commenters asked that the CSA provide greater clarity around what can be used as a reference index, for instance whether fund managers may use blended	The Proposed Methodology allows for the use of blended indices and requires that if the reference index has changed since the last prospectus, the prospectus provides

	indices and if so, whether such use must be disclosed in the mutual fund's prospectus. It should also be clarified in what circumstances, if any, a change in reference index from what was originally disclosed would constitute a material change.	details of when and why the change was made.
	Several commenters suggested that the reference index be consistent with the broad-based market index chosen for the Management Report of Fund Performance (**MRFP**). Applying different criteria for the MRFPs and the fund's risk classification will create confusion for both investors and dealers added another commenter.	The same index or indices used in the MRFP of a mutual fund can be used to determine its investment risk level if the index or indices reflect the risk profile of the fund and meets the criteria for an appropriate reference index as outlined in the Proposed Methodology.
	Two commenters agreed that fund managers should have the discretion to select an appropriate reference index to increase the information set of a fund to 10 years. These commenters would, therefore, extend this consideration to also allow using imputed data in situations where a fund's past returns are not representative of the fund's current attributes due to material and intentional changes to the fund. For example, if a mutual fund's securityholders vote to modify the fundamental investment objectives of a mutual fund, such that the returns of the fund would behave	We agree with the comments made and have made some changes to the 2013 Proposal to address instances where there has been a fundamental change in the investment objectives or a reorganization of a mutual fund.

	differently than it has previously, essentially making it a new mutual fund. One of these commenters also wanted to caution the CSA that determining an appropriate reference index may be difficult for mutual funds with volatility of returns that are different than any existing reference index.	
	One commenter noted that there is no perfect solution to choosing a reference index and that the investment objectives of some mutual funds are so flexible and unique that none of the widely available benchmarks capture the mutual fund's exposure or strategy. Two commenters were of the view that a mutual fund's returns may not be highly correlated to the index because of the mutual fund's active investment strategies The 2013 Proposal requires a reference index to meet each of the stated criteria which prove particularly difficult for innovative mutual funds where risk management is held out as a defining feature of the mandate, such as low volatility and target return funds.	According to the criteria for a reference index set out in the Proposed Methodology, the returns of the reference index should be *correlated* to the returns of the mutual fund, rather than replicate the returns exactly. As such, we believe there are sufficient reference indices available that can serve as a proxy for the risk profile of actively managed funds.
	Another commenter proposed that the CSA should consider Canadian Investment Funds Standards Committee (**CIFSC**) category-based benchmarks as potential proxies because they are better	Fund managers have discretion in their selection of the reference index as long as the reference index appropriately reflects the risk profile of the fund's investment objectives and meets, among other things,

	proxies for the investor experience than market-based benchmarks.	the criteria outlined by the CSA in regard to what is an appropriate reference index.
	One commenter requested clarification on the conditions that the indices be "widely recognized" and "publicly available". On the criterion of "publicly available", the commenter noted that very few index publishers issue monthly data or make the SD of index returns available to the public free of charge. The commenter also noted that many fund types, such as sector funds, real estate funds, high yield funds and floating rate debt funds, would generally find the most suitable proxies among indices that are neither widely recognized nor whose data is publicly available.	In response to comments, we have removed the requirement that the reference index be widely recognized and publicly available in all instances.
	Two commenters believed there may be some concerns surrounding the practice of the fund managers selecting their own reference indexes as fund managers may aim keep the risk rating of their fund at a certain level. In such instances, the fund manager could choose an index with the lowest possible investment risk level while abiding by the lax criteria put forth by the CSA. Having a third party, such as data providers or industry participants, select the reference index on behalf of	We believe that the requirement to disclose the chosen reference index in a mutual fund's prospectus allows for transparency. Where CSA staff have questions around the appropriateness of a reference index, the mutual fund may be the subject of a continuous disclosure review in this area.

	the fund manager would eliminate the conflict of interest. One of these commenters also had concerns as to whether or not the CSA has the means to effectively monitor index selection to ensure the chosen benchmarks accurately reflect the potential volatility of a mutual fund.	
	One commenter was of the view that certain fund of funds may not have the requisite 10 year history however, the underlying fund may have been in existence for a longer time period. In this case, using the returns of a reference index would not be a meaningful representation of a fund's risk level, rather preference should be given to the performance history of the underlying fund which may have been in existence for a longer time period.	In instances where the underlying fund has a 10 year history, and the top fund's stated investment objectives and strategy is to "clone" that underlying fund, staff may consider allowing, through exemptive relief, the use of the underlying fund's volatility of returns for the purposes of determining the top fund's investment risk level.
	Two commenters believed that the consultation paper should have provided details of exactly how costless index returns are to be adjusted in order to link to actual after-fee fund returns to obtain 120 data points where actual data is less than 10 years.	We do not propose that index data be adjusted for fees. We do not believe fees impact volatility of returns to a significant extent.

11. Keeping the criteria outlined in the introduction above in mind, **i. Do you agree with the proposed number of risk bands, the risk band break-points, and nomenclature used for risk band categories?** **ii. Do the proposed break points allow for sufficient distinction between funds with varying asset class exposures/risk factors?** **If not, please propose an alternative, and indicate why your proposal would be more meaningful to investors.** **Please supplement your recommendations with data/analysis wherever possible.**	Several commenters told us that the 2013 Proposal's risk bands and associated risk categories will lead to a large number of mutual funds being re-classified into a higher investment risk level, without any associated change in the mutual fund's risk. According to two of these commenters, between 70% to 80% of their mutual funds would move upwards to a higher investment risk level under the 2013 Proposal. One of the commenters did not believe that it is necessary to have a "Very High" investment risk level as there are very few mutual funds which would be included in this band. A few commenters recommended that the CSA use the same number of risk bands and the same nomenclature as described in the IFIC Methodology to avoid investor confusion and industry disruption. One commenter preferred the use of 5 risk categories rather than 6 for the reason that current *know your client* (**KYC**) are based on 5 band risk tolerance levels. According to the commenter, losing the symmetry between the KYC classification and the *know your product* (**KYP**) investment risk level from the Fund Facts will seem illogical and create confusion for investors and their advisors.	In response to the concerns expressed by commenters about the change in the risk scale from 5 categories to 6 categories and the associated costs, the CSA are proposing to retain the current CSA five-band risk scale used in the Fund Facts to avoid unnecessary reclassification of mutual funds and suitability reassessments which may be triggered as a result. While our intention in proposing a six band risk scale was to improve the segregation of asset classes across risk bands, we acknowledge stakeholders concerns raised in this regard.

	Two commenters noted that under the 2013 Proposal, the majority of mutual funds would be labeled as "Medium-to-High", while typically exhibiting only a fraction of the volatility of the highest risk investments. Given the range of investment options and associated investment risk levels, it is not intuitive that broad-based equity mutual funds, which typically exhibit risk levels consistent with broad markets, would be have a "Medium-to-High" investment risk level. Several commenters queried whether the additional investment risk level of "Very High" is necessary in light of it extremely limited applicability. One of these commenters urged the CSA to consider an alternate labeling system with investment risk levels ranging from "Very Low" to "High" which would limit unnecessary material change filings, prospectus amendments and suitability reviews which would ultimately be more cost-effective and minimize confusion for investors in this area. Along the same line, a few commenters questioned why this new risk scale is any better than the current scale, given that it	

	was the CSA that developed the current risk scale (mandated in conjunction with the Fund Facts regime introduced in January 2011). One commenter questioned the meaning of the CSA's explanation that the new investment risk levels will achieve "more meaningful volatility clustering in the fund universe" and also asked how the new risk bands – including the new sixth band - achieve this. One commenter believed that the thresholds have been set somewhat too low; i.e., the proposed bands place mutual funds that the commenter believed should be in a lower risk category into a higher one. One commenter fundamentally disagreed with the CSA's proposal to fix the risk band break points. The fundamental problem is that values of the ranges were presumably selected to represent the riskiness of specific asset classes over some historical period, but there is no guarantee that the values will continue to do so in the future, as the risk levels of asset classes' change over time. For this reason the commenter favoured a system with floating risk bands. According to two commenters, applying the 2013 Proposal while maintaining the	

	bands and labels from the IFIC Methodology would result in fewer funds requiring re-classification during implementation of the 2013 Proposal. This approach would also significantly reduce the transition time. One commenter believed that there should be a distinction between mutual funds that claim to offer full principal stability, such as money market funds, and those that offer high but not complete principal stability. The commenter added that there would be a benefit to adopting the same 7 band scheme as the CESR methodology. For the benefit of the investor and to provide a clearer picture of the actual risk level of the mutual fund, one commenter proposed that rather than increasing the number of risk categories available, the CSA simply require mutual funds to indicate its SD on the risk scale in the Fund Facts. In this manner, an investor would have a more accurate indication of the relative risk level for the mutual fund and an easy way to compare mutual funds with similar mandates, and the need to reclassify investment risk levels and/or increase the number of risk bands is reduced.	

	Two commenters acknowledged that adopting the 2013 Proposal may result in changes to the investment risk level for some mutual funds. However, the commenters submitted that the need for some reclassification of funds into a different (and more accurate) investment risk level is not a valid reason not to adopt a standardized risk classification methodology.	
12. Do you agree with the proposed process for monitoring risk ratings? **Keeping the criteria outlined in the introduction above in mind, would you propose a different set of parameters or different frequency for monitoring risk rating changes?** **If yes, please explain your reasoning. Please supplement your recommendations with data/analysis wherever possible.**	The majority of commenters believed that monthly monitoring is excessive and burdensome. Several commenters recommended semi-annual or annual monitoring. Several other commenters recommended that the CSA simply adopt an annual monitoring process that is tied to a fund's annual renewal and that it be aligned with other instances where there is a material change to the business, operations or affairs of a fund (e.g. change of fundamental investment objective, merger, etc.). Some of these commenters were concerned with how the proposed monthly monitoring process would apply to "borderline" mutual funds that sit on the higher end of a risk band range. These mutual funds would typically fluctuate between two risk bands from month to month, which, under the 2013 Proposal, would require more frequent re-	To address the comments raised regarding the regulatory burden, the Proposed Methodology requires the frequency of determining the investment risk level of a mutual fund to be at least annually, and within 60 days of the date of the Fund Facts or ETF Facts. This is a minimum frequency requirement and the investment risk level of the mutual fund should be reassessed more frequently, as appropriate.

	classification. Where a fund manager is required to re-classify a borderline mutual fund more frequently, an amended Fund Facts and press release must be filed within 10 days of the last monthly calculation of the fund's SD. This is costly, burdensome and would likely lead to investor confusion. One commenter commented that a risk classification methodology should provide a means to ensure that short-term fluctuations in investment risk levels are minimized. The 2013 Proposal seeks to avoid such short-term fluctuations by providing two tests associated with the monthly calculation. However, the commenter found these tests to be a bit confusing and potentially contradictory. The commenter pointed to the CESR methodology as being more intuitive, with less potential to provide contradictory signals. One of these commenters recommended that any changes to a mutual fund's investment risk level should be a required discussion point in the fund's MRFP under National Instrument 81-106 *Investment Fund Continuous Disclosure* (**NI 81-106**) for the period of the change. Other commenters agreed with the proposed process for monitoring	

	investment risk levels. One commenter added that the process appears reasonable given that the purpose of the monitoring is to promptly alert investors of a material change in a mutual fund's investment risk level. One commenter acknowledged that although necessary, monitoring and changing investment risk levels is time consuming and costly and these costs may well be passed on to investors.	
13. Is a 10 year record retention period too long? **If yes, what period would you suggest instead and why?**	The vast majority of commenters suggested that the CSA limit the data retention period to 7 years. These commenters referenced paragraph 11.6(1)(a) of National Instrument 31-103 *Registration Requirements and Exemptions*. Another commenter suggested that a 7 year data retention period would be consistent with the Mutual Fund Dealers Association of Canada (MFDA) rules on the retention of documents. Two commenters were of the view that a minimum of 10 year be prescribed as a record retention period.	After considering the comments received, the CSA has removed the requirement to maintain records for a ten year period. The requirement in securities legislation to maintain records for a period of seven years from the date the record was created applies.
14. Please comment on any transition issues that you think might arise as a result of risk classification changes that	According to several commenters, the 2013 Proposal would cause significant disruption to dealers and investors due to	In response to commenters' concerns regarding unnecessary disruption to the industry, including dealers, we are

are likely to occur upon the initial application of the 2013 Proposal. **How would IFMs and dealers propose to minimize the impact of these issues?**	a large number of mutual funds moving to higher risk classifications. This will create a burdensome process for the advisors as there will be a need to review thousands of accounts and meet with thousands of investors to ensure ongoing suitability. Similarly, another commenter added that advisors and clients will have to determine whether the client should sell an investment as a result of the investment risk level change, potentially incurring taxable gains or losses or selling at an inopportune time, and raising costs for investors. According to one commenter, another issue is the amendments of related regulatory documents as a result of fund risk ratings changes within the 10 day material change filing window. Fund managers may also be required to issue a press release to this effect. The commenter encouraged the CSA to consider the next filing of annual renewal of regulatory documents as a window for implementation of a risk rating change. Commenters suggested various timelines for transition for both fund managers and for dealers. Commenters suggestions ranged from 6 – 18 month transition timelines for fund managers to transition	proposing to retain the current five band risk scale. The proposed risk bands in the Proposed Methodology are also consistent with the IFIC Methodology which should minimize transition issues as the IFIC Methodology is widely used in industry. As a result, we expect any impact of implementing the Proposed Methodology to be minimal for fund managers, dealers and investors. Overall, we believe that the benefits of improved comparability of investment risk levels across mutual funds are proportionate to the costs of implementing a CSA mandated methodology. We are proposing that the Proposed Methodology be in-force after ministerial approval, i.e. 3 months after final publication of the proposed amendments. Once the Proposed Methodology is in force, mutual funds would be required to use the Proposed Methodology for each filing of the Fund Facts or ETF Facts, as applicable. This will allow mutual funds to transition to the Proposed Methodology according to their renewal prospectus schedule.

	to the new risk classification methodology, followed by 12 – 24 months for dealers to adjust and respond to the risk classification changes arising from implementation of the 2013 Proposal. One commenter told use that a two year transition period should be sufficient for implementation, in recognition of the annual cycle followed by most fund managers in updating Fund Facts, i.e. by the end of two years after the requirement taking effect, all updates will have been completed.	
	In terms of the potential impact to dealers, advisors and investors, three commenters suggested that the CSA work closely with the self-regulatory organizations (**SRO**s) to determine a suitable time period to allow dealers and advisors to consider the impact on investors of holding a mutual fund that has an investment risk level change as a result of the transition to the 2013 Proposal. In addition, the CSA and/or SROs should advise that a change in the assigned investment risk level from the adoption of the 2013 Proposal does not mean that the investment risk level of the fund has changed. Furthermore, investors should not necessarily be redeemed out	The CSA will continue to keep the SROs engaged as we proceed with implementation of the Proposed Methodology.

	of the particular fund due solely to the implementation of a mandated methodology. Commenters recommended that SROs publish guidance alongside proposed consequential rule changes so that the stakeholders can provide timely input to both the CSA and the SROs on the proposed means to achieve the stated regulatory objectives.	
	One commenter suggested that when developing transition to any new rules, it is of utmost importance that the CSA keep in mind: (i) the ongoing work within the industry to comply with the Client Relationship Model - Phase 2 (**CRM2**) requirements that came into force in July 2013 and that any changes to investment risk levels of mutual funds can only be put in place at the earliest towards the end of 2016 or the beginning of 2017; and (ii) the recent choice of the CSA of mid-month dates, such as May 13 and June 13 (Fund Facts) and July 15 (CRM2), has significant implications for industry participants and the commenter urged the CSA to return to using calendar month-end dates, as well as dates that have a logical linkage to the new requirements and common industry timing, in order to ease transition. Finally, any changes in risk classification should also be communicated to existing	The CSA are mindful that there are 2 concurrent workstreams relating to the Proposed Methodology and the ETF Facts. We will endeavour to co-ordinate transition periods for final amendments where possible.

	investors, perhaps by reference in the semi-annual and annual MRFPs required by NI 81-106. To reduce the costs and logistical complexity to fund managers resulting from successive, incremental changes to form requirements, the commenter strongly encouraged the CSA to, where possible, consider aggregating proposed changes through the use of transitional periods such that they apply at the same time.	

Part IV - Other proposals from commenters		
<u>Issue</u>	**<u>Comments</u>**	**<u>Responses</u>**
Fund mergers/ conversions	A few commenters suggested that the 2013 Proposal should provide specific guidance around how to determine the investment risk level of the continuing fund in the case of a fund merger. Another commenter felt that in a fund merger situation, there needs to be clear rules surrounding the use of historical returns, particularly if the mutual funds are from distinctly different asset classes or investment strategies. It may be beneficial to set a limit on how much the	The Proposed Methodology has been amended to include specific provisions where there are fundamental changes to the investment objectives of a mutual fund or a reorganization or transfer of assets of a mutual fund.

	investment risk level on the newly merged investment fund can be lowered. One commenter suggested that where an older fund's series of securities are being merged into a newer series of securities of the same fund, the returns of the older series of securities should be used to calculate the SD. One of these commenters also wondered how to handle the situation where a closed-end fund converts to a mutual fund. The commenter wondered if the CSA will permit using historical closed-end fund data.	

Part V – List of commenters
<u>Commenters</u>
Advocis AGF Investments Inc. Alternative Investment Management Association (AIMA) Association of Canadian Compliance Professionals AUM Law Professional Corporation Borden Ladner Gervais LLP Bullion Management Services Inc. Canadian ETF Association (CETFA) Canadian Advocacy Council for Canadian CFA Institute Societies Canadian Foundation for Advancement of Investor Rights (FAIR) Capital International Asset Management (Canada), Inc. Christison, George STI, CIM, FMA, FCSI

CI Investments Inc.
CIBC
Consumers Council of Canada
Dr. Sinha, Rajeeva
Dynamic Funds
Elford, Larry
Federation of Mutual Fund Dealers
Fidelity Investments Canada ULC
Financial Planning Standards Council (FPSC)
Franklin Templeton Investments Corp.
Fundata Canada Inc.
Gourley, Stan
Hallett, Dan
HollisWealth and Holliswealth Advisory Services Inc.
Invesco Canada Ltd.
Investment Funds Institute of Canada (IFIC)
Investment Industry Association of Canada (IIAC)
Investment Planning Counsel Inc., IPC Investment Corporation , Counsel Portfolio Services , and IPC Securities Corporation
Investor Advisory Panel
Investors Group Inc.
Kenmar Associates
Mackenzie Financial Corporation
McFadden, Debra
Morningstar Research Inc.
Mouvement d'éducation et de défense des actionnaires (MÉDAC)
Mouvement des caisses Desjardins
National Bank Securities Inc. and National Bank Financial
NEI Investments
Picard, Denys
Portfolio Management Association of Canada (PMAC)
Portfolio Audit
Portfolio Aid Inc.
PFSL Investments Canada Ltd. (Primerica)

Quadrus Investment Services Ltd.
RBC Global Asset Management Inc., RBC Dominion Securities Inc., Royal Mutual Funds Inc. and Phillips, Hager & North Investment Funds Ltd.
Ross, Arthur
Scotia Securities Inc.
ScotiaFunds
ScotiaMcLeod
Shalle, William
Small Investor Protection Association (SIPA)
Sullivan, Patrick
TD Asset Management Inc.
Teasdale, Andrew

ANNEX B

Proposed Amendments to National Instrument 81-102 *Investment Funds*

1. National Instrument 81-102 Investment Funds is amended by this Instrument.

2. The Instrument is amended by adding the following Part:

PART 15.1 INVESTMENT RISK CLASSIFICATION METHODOLOGY

15.1.1 Use of Investment Risk Classification Methodology – A mutual fund must:

(a) determine its investment risk level, at least annually, in accordance with Appendix F– *Investment Risk Classification Methodology*; and

(b) disclose its investment risk level in the fund facts document in accordance with Part I, Item 4 of Form 81-101F3, or the ETF facts document in accordance with Part I, Item 4 of Form 41-101F4, as applicable**.**.

3. The Instrument is amended by adding the following Appendix F:

APPENDIX F– INVESTMENT RISK CLASSIFICATION METHODOLOGY

Commentary

This Appendix contains rules and accompanying commentary on those rules. Each member jurisdiction of the Canadian Securities Administrators (the CSA or we) have made these rules under authority granted to it under the securities legislation of its jurisdiction.

The commentary explains the implications of a rule, offer examples or indicate different ways to comply with a rule. It may expand on a particular subject without being exhaustive. The commentary is not legally binding, but it does reflect the views of the CSA. Commentary always appears in italics and is titled "Commentary."

Item 1 Investment risk level

(1) Subject to subsection (2), to determine the "investment risk level" of a mutual fund,

(a) determine the mutual fund's standard deviation in accordance with Item 2 and, as applicable, Item 3, 4 or 5,

(b) in the table below, locate the range of standard deviation within which the mutual fund's standard deviation falls, and

(c) identify the investment risk level set opposite the applicable range.

Standard Deviation Range	**Investment Risk Level**
0 to less than 6	Low
6 to less than 11	Low to medium
11 to less than 16	Medium
16 to less than 20	Medium to High
20 or greater	High

(2) Despite subsection (1), the investment risk level of a mutual fund may be increased if doing so is reasonable in the circumstances.

(3) A mutual fund must keep and maintain records that document:

(a) how the investment risk level of a mutual fund was determined, and

(b) if the investment risk level of a mutual fund was increased, why it was reasonable to do so in the circumstances.

Commentary:

(1) The investment risk level may be determined more frequently than annually. We would generally expect that the investment risk level be determined again whenever it is no longer reasonable in the circumstances.

(2) We would generally consider a change to the mutual fund's investment risk level disclosed on the most recently filed fund facts document or ETF facts document, as applicable, to be a material change under securities legislation in accordance with Part 11 of National Instrument 81-106 Investment Fund Continuous Disclosure.

Item 2 Standard deviation

(1) A mutual fund must calculate its standard deviation for the most recent 10 years as follows:

Standard Deviation	$\sqrt{12} \times \sqrt{\frac{1}{n-1} \sum_{i=1}^{n} (R_i - \overline{R})^2}$
where	n = 120 months R_i = return on investment in month i $\overline{R}$ = average monthly return on investment

(2) For the purposes of subsection (1), a mutual fund must make the calculation with respect to the series or class of securities of the mutual fund that first became available to the public and calculate the "return on investment" for each month using:

(a) the net asset value of the mutual fund, assuming the reinvestment of all income and capital gain distributions in additional securities of the mutual fund;

(b) the same currency in which the series or class is offered.

Commentary:

For the purposes of Item 2, except for seed capital, the date on which the series or class of securities "first became available to the public" generally corresponds to on or about the date on which the securities of the series or class were first issued to investors.

Item 3 Difference in classes or series of securities of a mutual fund

(1) Despite Item 2(2), if a series or class of securities of the mutual fund has an attribute that results in a different investment risk level for the series or class than the investment risk level of the mutual fund, the "return on investment" for that series or class of securities must be used to calculate the standard deviation of that particular series or class of securities.

Commentary:

Generally, all series or classes of securities of a mutual fund will have the same investment risk level as determined by Items 1 and 2. However, a particular series or class of securities of a mutual fund may have a different investment risk level than the other series or classes of securities of the same mutual fund if that series or class of securities has an attribute that differs from the other. For example, a series or class of securities that employs currency hedging or that is offered in the currency of the United States of America (if the mutual fund is otherwise offered in the currency of Canada) has an attribute that could result in a different investment risk level than that of the mutual fund.

Item 4 Mutual funds with less than 10 years of history

(1) For the purposes of Item 2, if it has been less than 10 years since securities of the mutual fund were first available to the public, the mutual fund must select a reference index that reasonably approximates the "return on investment" of the mutual fund.

(2) When using a reference index, a mutual fund must:

(a) monitor the reasonableness of the reference index on an annual basis or more frequently if necessary,

(b) disclose in the mutual fund's prospectus in Part B, Item 9.1 of Form 81-101F1 or Part B, Item 12.2 of Form 41-101F2, as applicable:

(i) a brief description of the reference index, and

(ii) if the reference index has changed since the last disclosure under this section, details of when and why the change was made.

Instructions:

(1) In selecting and monitoring the reasonableness of a reference index, a mutual fund should consider a number of factors including whether the reference index:

(a) is made up of one or a composite of several market indices that best reflect the returns and volatility of the mutual fund and the portfolio of the mutual fund;

(b) has returns highly correlated to the returns of the mutual fund;

(c) contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations;

(d) has a historical systemic risk profile highly similar to the mutual fund;

(e) reflects the market sectors in which the mutual fund is investing;

(f) has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets;

(g) is denominated, in or converted into, the same currency as the mutual fund's reported net asset value;

(h) has its returns computed on the same basis (e.g., total return, net of withholding taxes, etc.) as the mutual fund's returns;

(i) is based on an index or indices that are each administered by an organization that is not affiliated with the mutual fund, its manager, portfolio manager or principal distributor, unless the index is widely recognized and used; and

(j) is based on an index or indices that have each been adjusted by its index provider to include the reinvestment of all income and capital gains distributions in additional securities of the mutual fund.

Item 5 Fundamental Changes

(1) For the purposes of Item 2, if there has been a reorganization or transfer of assets of the mutual fund pursuant to paragraphs 5.1(1)(f) or (g) or subparagraph 5.1(1)(h)(i) of the Instrument, the standard deviation must be calculated using the monthly "return on investment" of the continuing mutual fund, as the case may be.

(2) Despite subsection (1), if there has been a change to the fundamental investment objectives of the mutual fund pursuant to paragraph 5.1(1)(c) of the Instrument, for the purposes of Item 2, the standard deviation must be calculated using the monthly "return on investment" of the mutual fund starting from the date of that change..

4. This Instrument comes into force on [●]. [Note: *90 days after final publication of this Instrument*].

ANNEX C

Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

1. National Instrument 81-101 Mutual Fund Prospectus Disclosure is amended by this Instrument.

2. Item 9.1 of Part B of Form 81-101F1 Contents of Simplified Prospectus is replaced with the following:

Item 9.1 Investment Risk Classification Methodology

If the mutual fund uses a reference index in accordance with Item (4) of Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds*, provide a brief description of the reference index, and if the reference index has been changed since the most recently filed prospectus, provide details of when and why the change was made.**.**

3. Item 4 of Part I of Form 81-101F3 Contents of Fund Facts Document is amended by

(a) replacing in paragraph (2)(a) "adopted by the manager of the mutual fund***" with "***prescribed by Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds*"**,**

(b) deleting in paragraph 2(a) "*mutual fund's*** ", and***

(c) replacing in the Instructions "adopted by the manager of the mutual fund***" with "***prescribed by Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds, as at the end of the period that ends within 60 days before the date of the fund facts document*"**.**

4. This Instrument comes into force on [●]. [Note: *90 days after final publication of this Instrument*].

ANNEX D

Proposed Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

1. The changes to Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure are set out in this Annex.

2. Subsection 2.1.1(5) is repealed.

3. Subsection 2.7(2) is changed by deleting "**or risk level**" from the last sentence.

4. These changes become effective on [●]. [Note: *90 days after final publication of this Instrument*].

ANNEX E

Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements*

1. National Instrument 41-101 General Prospectus Requirements is amended by this Instrument.

2. Section 12.2[1] of Form 41-101F2 Information Required In An Investment Fund Prospectus is replaced with the following:

12.2 Investment Risk Classification Methodology

If the ETF uses a reference index in accordance with Item (4) of Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds*, provide a brief description of the reference index, and if the reference index has been changed from the most recently filed prospectus, provide details of when and why the change was made**.**.

3. Item 4[2] of Part I of Form 41-101F4 Information Required In An ETF Facts Document is amended by

(a) replacing in paragraph(2)(a) "adopted by the manager of the ETF***" with "***prescribed by Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds****",***

(b) deleting in paragraph (2)(a) "*ETF's****", and***

(c) replacing in the Instructions "adopted by the manager of the ETF***" with "***prescribed by Appendix F *Investment Risk Classification Methodology* to National Instrument 81-102 *Investment Funds, as at the end of the period that ends within 60 days before the date of the ETF facts document****".***

4. This Instrument comes into force on [•]. [Note: 90 days after final publication of this Instrument].

[1] As published for comment on June 18, 2015 in "CSA Notice and Request for Comment: Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery, Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements* and to Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements* and Related Consequential Amendments".

[2] See footnote 1.

ANNEX F

Proposed Changes to Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements*

1. The changes to Companion Policy 41-101CP to National Instrument 41-101 General Prospectus Requirements are set out in this Annex.

2. Subsection 5A.1. (3)[1] is repealed.

3. Subsection 5A.3. (4)[2] is changed by deleting "or risk level***" from the last sentence.***

4. This change becomes effective on [●]. [Note: *90 days after final publication of this Instrument*].

[1] As published for comment on June 18, 2015 in "CSA Notice and Request for Comment: Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery, Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements* and to Companion Policy 41-101CP to National Instrument 41-101 *General Prospectus Requirements* and Related Consequential Amendments".
[2] See footnote 1.

ANNEX G

Local Matters

There are no applicable local matters in Alberta to consider at this time.

March 8, 2016

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marches financiers
800, rue du Square-Victoria, 22e étage
C.P. 246 tour de la Bourse
Montréal QC H4Z 1G3
By email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
Attention: The Secretary
By email: comments@osc.gov.on.ca

Dear Mesdames and Sirs:

RE: CSA MUTUAL FUND RISK CLASSIFICATION METHODOLOGY
FOR USE IN FUND FACTS AND ETF FACTS
PROPOSED AMENDEMENTS TO NATIONAL INSTRUMENT 81-102 *INVESTMENT FUNDS*

INTRODUCTION

Thank you for this opportunity to comment on proposed amendments to NI 81-102 pursuant to Risk Classification Methodology.

My colleagues and I commend staff efforts to introduce and standardize the important concept of risk to investors. This first step can only lead to more informed decisions by investors and their advisors. We encourage extending risk analysis to include investor portfolios, a move that can benefit most investors in the shortest time, specifically moving the industry beyond suitability to a more relevant standard. Our interest is as practitioners using risk extensively in decision making.

PŮR Investing Inc. specializes in risk analysis and portfolio construction for individual investors. The ETF screener, designed and powered by PŮR and available for free on the TMX Money website, http://www.tmxmoney.com/en/investor_tools/etf_screener.html, allows the public to examine, screen and compare Canadian-traded exchange traded funds on an array of important characteristics. We plan to include mutual funds on the same platform during 2016. The firm's ePAT™ portfolio allocation tool that helps investment advisors build and analyze constant risk-based portfolios is a global first. Our peer-reviewed papers on the use of risk-based portfolios for individuals (Rotman International Journal of Pension Management), has led to PŮR's reputation as a global thought leader in defined contribution (DC) pension design (van Wyck and Ezra, 2015).

EXECUTIVE SUMMARY

The use of standard deviation (SD) is a sound foundation for examining and measuring risk. However, considering how this information is to be used (Fund Facts), and given the characteristics and limitations of both SD and investor and advisor comprehension, we believe the risk methodology as proposed for NI 81-102 can be improved to be more consistent with the principles of full, true and plain disclosure, promote transparency and reduce conflicts of interest arising from use of reference indices for funds with less than 10 years of data. Investors and advisors would also benefit from seeing how their prospective or existing investments compare with a) a benchmark that is relevant and b) other investments in the same asset class(es). Specifically, to improve the legitimacy of risk disclosure, we recommend that:

- only actual performance be used for SD calculations to improve confidence in the process;
- a single universal benchmark index (UBI): like 60% equities (20% Canadian/ 20% U.S./ 20% International) and 40% Canadian bonds be introduced to help investors/advisors understand/explain relative risks.

DISCUSSION

Only actual performance should be used for SD calculations because:

- 80% of funds do not have 10 years of performance history;
- actual performance is more credible than hypothetical performance.

Using a 10 year average helps smooth variability, but the use of "reference indices" by 80% of funds without actual full period returns, means that a preponderance of subjective variables will be introduced to what should be a completely quantitative measure. Product proliferation, in particular new ETFs, will exacerbate an already suboptimal situation. Minimizing product provider input, even if the ten instruction points were rigorous (Annex B Item 4 (2)(a) (ii)) would limit perceived conflicts of interest particularly if 42% will not achieve even 5 years of performance history. Survivorship for key asset classes in the five-year period ending June 2015 was only 58.11% for Canadian equity funds , 66.32% (U.S. Equity), 75.56% (International Equity), and 68.53% (Global Equity). Fully 42% of Canadian equity mutual funds were merged or closed in the past 5 years. (SPIVA). Confidence in risk ratings should and would be low. Risk ratings that lack legitimacy will not be used by serious practitioners.

A problem is that investors, advisors and regulators want stable long term risk ratings. But SD is not static. NI 81-102's proposed fixed five category investment risk level grid will lead to risk rating changes over time that will confuse many investors and their advisors. Example: By 2020, 2008-2009 market volatility drops off 10 year averages and, assuming volatility remains even at today's somewhat elevated levels, all risks will fall and reverse the increases to which some observers have referred in comments to the initial proposal.

A 20 year average would be better but is impractical. We offer an alternative approach. Funds with fewer than ten years of data should be required to:

1. report SD based on actual DAILY performance after one year for new funds (consistent with one year performance reporting standards) or for the longest available period, i.e., 2 years, 3 years, 4 years to 10 years;
2. provide parallel period SD for a universal benchmark index (UBI) calculated using daily returns over the same period;
3. graphically show resulting product SD as a percentage difference from UBI SD for the longest available period with a 1 year minimum (i.e., Product SD 17.2, UBI SD 10.0: Product is 72% more volatile than the UBI) see illustration for XIU next page;
4. provide a range of SD for the appropriate asset class for comparison purposes .

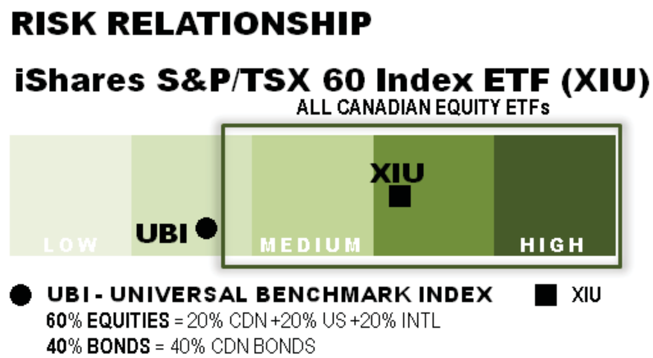
ADVANTAGES

UBI SD establishes a reference point against which all investment products, including individual securities, can be compared over all time periods;

- Investors/advisors can compare the SD of an investment relative to the SD of the UBI - better than showing an SD number that will be meaningless or confusing to most readers.
- The new product's SD *relative* to the UBI can be used as a proxy with additional periods providing confirmation. Daily data for one year provides 251 data points providing a 95% confidence level that the estimate is within 10% - better than monthly data over 10 years using 120 data points albeit without the smoothing of time.
- Fund companies and ETF sponsors already calculate and maintain unit values daily, so SD calculations will not be difficult or expensive.
- A single reference benchmark is less confusing than multiple benchmarks (i.e., one for each asset class).
- The relationship between the SD of a new fund (or any fund with less than 10 years history) and the UBI SD is relatively stable but importantly is unlikely to *underestimate* the relative risk rating during short term periods of higher volatility. See example below.

Example: iShares S&P TSX 60 Index ETF (XIU) with a 10 year SD of 17.2 is shown relative to the UBI SD of 10.0. During the financial crisis, 2008-2009, UBI's one year average SD spiked to over 24 and XIU's SD spiked to 57. Had XIU been launched in 2007 its SD would have been 137.5% higher than UBI's SD

[(57/24) -100]. Using UBI's 10 year average SD of 10 as a reference point, XIU would have been rated "High" (>20). This would have been appropriate given the volatility at that time. In the illustration of Risk Relationship below, three key pieces of information are the position of UBI, the position of XIU relative to UBI, and the relative position of XIU to all Canadian Equity ETFs defined by the rectangle. The implied information is that XIU is riskier than the diversified UBI but slightly below median among all Canadian equity ETFs.



Other categories: U.S. equity, International equity, global equity, emerging market equities, Canadian bonds, International bonds, emerging market bonds, diversified fund strategies. The fewer the categories the better.

SUMMARY

Using standard deviation is a good first step to improving investor risk disclosure. Employing actual performance increases the legitimacy of the measure and improves its credibility. Conversely, the use of a reference index for funds with less than 10 years of actual performance data is a disservice to investors because it encourages subjectivity and is vulnerable to conflicts of interest, providing numbers with little validity and no reliability. Using a relative measure like a UBI gives context and meaning to the otherwise opaque concept of risk. Extending the idea to measure each investor's portfolio would further improve disclosure and expectations and promote better and more appropriate portfolio construction.

Yours truly,

Mark S. Yamada
President & Chief Executive Officer
PŮR Investing Inc.

IIACACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Naomi Solomon
Managing Director
nsolomon@iiac.ca

Via Email: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Attention: The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs / Mesdames:

Re: CSA Request for Comment - CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts (the "Proposed Methodology")

The Investment Industry Association of Canada (the "IIAC") appreciates the opportunity to provide additional input on the Proposed Methodology. The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 144 investment dealer member firms ("IIAC Members") that are regulated by the Investment Industry Regulatory Organization of Canada ("IIROC"). These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations that is fundamental to economic growth.

The IIAC commends the CSA for retaining the standard deviation risk indicator and adopting a five-category scale as part of the Proposed Methodology, given the concern over impact to dealers and their clients that would occur from changes in investment risk levels for mutual funds. Implementation of the Proposed Methodology should provide investors with consistency and stability of measures necessary for more meaningful evaluation of risk for these products. We are also pleased to see that the CSA has adopted a more reasonable annual frequency for determining the investment risk level of a mutual fund rather than monthly, to mitigate the possibility of dealer and investor confusion from frequent risk rating changes.

While the Proposed Methodology is generally improved, the IIAC recommends that the CSA refine it further as indicated in the comments below, to ensure a positive investor experience and an efficient and effective implementation.

Use of a Reference Index for Funds with Less than 10 Years of History

The IIAC supports the CSA's decision to remove a list of criteria considered acceptable as a reference index, however we also urge the CSA not to require the reference index principles to be followed uniformly as impractical in certain circumstances. Particularly in the case of innovative and actively managed investment funds where it would be necessary to build an index, if investment fund managers (IFMs) cannot create a reference index to meet the principles, such as highly correlated returns or a high proportion of securities represented with similar portfolio allocations, the lack of flexibility would likely curtail manufacture of these products as an unintended consequence. Imposing the reference index principles uniformly thus risks constraining product innovation to the investor's detriment.

The IIAC agrees with the recommendation made by certain IFMs or other commenters in the previous comment period, that the selection of a reference index or blend of indices not be prescriptive in all cases and that it allow the IFM to retain discretion to determine what reasonably represents the fund's risk rating. This acknowledges the IFM's fiduciary responsibilities, their position to best assess risk and how it applies to the fund and allows flexibility to appropriately accommodate innovative products. Moreover, as acknowledged by the CSA, the reference index is in any event subject to regulatory scrutiny through continuous disclosure review. We agree with the suggestion made by the Investment Funds Institute of Canada (IFIC), that the use of discretion be disclosed in the description of the reference index to be included in the Management Report of Fund Performance (MRFP).

Mechanism for Maintaining Relevance of Fund Risk Classification Methodology

Whereas IFIC engaged a fund risk classification task force to conduct a yearly review IFIC's fund risk methodology to ensure it retained relevance, a similar mechanism would be useful for the CSA to employ to ensure that standard deviation ranges in the Proposed Methodology remain relevant through periods of higher and lower general market volatility. We would recommend that a CSA committee open to industry stakeholders be established and that an annual review of the methodology be conducted. We would also like to confirm that any future proposed changes to the methodology would be subject to the CSA's public comment process.

Transition

The IIAC notes that the CSA's proposal respecting "ETF Facts" disclosure has provided for a risk-rating section. We recommended in response to the ETF Facts proposal, among other things, that it be co-ordinated with the Proposed Methodology which is intended to apply to ETFs as well. Given that the ETF Facts amendments are not finalized, the timeframe for implementation of ETF Facts is not yet established, and that the ETF Facts filing deadline was proposed to be around 2 years from final publication of amendments, we question how the accelerated implementation of the Proposed Methodology by the fall of 2016 can be applied in the case of ETFs. We recommend that the final Proposed Methodology be effective only once the transition period for the ETF Facts has elapsed so that all funds will be applying the risk rating methodology consistently.

We appreciate your consideration of our comments on the Proposed Methodology and would be pleased to discuss this further should there be any questions.

Yours sincerely,

"Naomi Solomon"

MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

VIA EMAIL

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintended of Securities
Office of the Superintendent of Securities, Nunavut

Me Anne-Marie Beaudoin
Corporate Secretary
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800, square Victoria 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: ***CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102*** **Investment Funds** ***and Related Consequential Amendments***

We thank you for the opportunity to comment on the CSA's mutual fund risk classification methodology for use in fund facts and ETF facts (the "**Proposed Methodology**"). Mackenzie Financial Corporation ("**Mackenzie Investments**") is a portfolio adviser and investment fund manager registered under National

Instrument 31-103 with total assets under management of over $59 billion as of January 31, 2016. Mackenzie Investments is a wholly-owned subsidiary of IGM Financial Inc., which is a member of the Power Financial Corporation group of companies. Mackenzie Investments distributes its products through more than 230 dealers representing over approximately 41,000 financial advisers. At Mackenzie Investments, we are committed to the financial success of investors, through their eyes.

We agree with the statement in the introduction to the Proposed Methodology that a standardized risk classification methodology provides for greater transparency and consistency, which will allow investors to more readily compare the investment risk levels of different mutual funds and/or ETFs.

Overall, we find the key changes from the 2013 proposal to be positive, and thank the CSA for their responsiveness. Our specific comments on the Proposed Methodology are set out below.

Application of Proposed Methodology to ETFs

We support the CSA's decision to apply the Proposed Methodology to both mutual funds and ETFs. We would continue to note, however, that the investment choices available to Canadian investors are not limited to mutual funds and ETFs, but include other types of investment funds and financial products. While we acknowledge that this is outside the scope of this publication, we strongly encourage the CSA to consider adopting the Proposed Methodology to all types of investment funds and financial products within its regulatory mandate and to work collaboratively with insurance and banking regulators to affect similar risk disclosure on competing investment products to mutual funds and ETFs, such as segregated funds and guaranteed investment certificates (GICs).

Five-Category Scale and Standard Deviation Ranges

We agree with the decision to keep the five-category scale currently prescribed in the Fund Facts and proposed ETF Facts. We are also supportive of the adoption of the standard deviation ("**SD**") ranges from the IFIC Methodology. Many fund managers currently use the IFIC five-category scale; therefore, maintaining the five bands will limit the disruption caused by reclassifying funds.

We note, however, that the Proposed Methodology is silent with respect to the frequency of review of the SD ranges. Currently, IFIC reviews its methodology annually through a risk classification task force. This ensures that a mutual fund's risk level stays relevant with current market trends and volatility. We believe such annual review is crucial with the introduction of the SD ranges, and strongly encourage the CSA to embed this commitment within the Proposed

Methodology. We believe an annual review by the CSA, working collaboratively with an industry advisory committee, would achieve the best outcome.

The need for such a review becomes more pertinent in the absence of permitting fund manager discretion to lower the investment risk level of a fund.

Use of a Reference Index

Mirrored Corporate Class and Trust Funds and Clone Funds

Although we are generally supportive of the requirement to use a reference index where a mutual fund does not have the requisite past performance history to calculate the fund's risk under the Proposed Methodology, we have identified some scenarios where another fund's performance, rather than a reference index, may be the more appropriate proxy. For example, we offer certain corporate class funds that essentially emulate the trust version. In these cases, the trust fund has 10 years of history, but the corporate class has less. Under the Proposed Methodology, the corporate class fund would be required to use a reference index rather than having the ability to use the trust fund's performance history, resulting in two identical funds having different risk ratings.[1] In such circumstances, we believe the Proposed Methodology should allow for the use of the longer performing fund's history in determining the risk level of both funds. Having two different risk ratings would likely cause unnecessary confusion.

Similarly, we note that in Annex A of the Proposed Methodology, the CSA has indicated that where a clone fund does not have 10 years of performance history, the manager can apply for exemptive relief to use the underlying fund's history instead of a reference index. We query why exemptive relief must be sought. We think in these instances the Proposed Methodology should permit the clone fund to use the underlying fund's history, without the need to seek exemptive relief.

Actively Managed Funds

We continue to be of the view that the use of a reference index, without the discretion of the fund manager to both increase and, in certain circumstances, decrease a fund's investment risk level, is problematic.

Our funds are designed to be actively managed and frequently do not resemble any index. Investors are paying us for active management and we believe that, among other things, this requires our funds to look and behave differently from indices. In other words, the purpose of our funds are not to be "highly correlated" to any index, a factor indentified in the Proposed Methodology for choosing a reference index. This can make identifying a reference index for new mutual funds, or those without the 10 year performance history, difficult. We

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[1] See Mackenzie Cundill Recovery Class and Mackenzie Cundill Recovery Fund; and Mackenzie Global Concentrated Class and Mackenzie Global Concentrated Fund.

acknowledge that a reference index must be used for all funds in our management report of fund performance ("**MRFP**"), however the purpose of a reference index in the MRFP is to compare performance, not to be a proxy for risk. We therefore continue to advocate for the ability of the fund manager to use discretion to adjust the investment risk level, either higher or lower, in certain circumstances, where a reference index is used.

Instructions when Choosing a Reference Index

With respect to the instructions in the Proposed Methodology on factors to consider in choosing a reference index, we find the wording unclear as to whether the factors are merely examples of considerations a manager should employ when identifying and choosing a reference index, or, if the CSA expects all factors listed to be met. For the reasons cited above, as well as for reasons to be articulated, we support fund managers having the flexibility to decide which of the factors listed in the instructions are relevant to the mutual fund for the purposes of choosing a reference index, as well as having the flexibility to consider factors outside of those listed in the Proposed Methodology.

If the index or indices used in the MRFP may be used as a reference index, as indicated in the notice, we would ask that this too be clarified in the Proposed Methodology or instructions.

We further find the factors in the instructions of the Proposed Methodology for identifying and choosing a reference index to be unnecessarily prescriptive. As we've stated, with actively managed funds it may be difficult to find a reference index that "contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations," as the purpose of actively managed funds is not to track an index. Similarly, identifying a reference index that has "returns highly correlated" to the fund does not necessarily indicate a correlation of volatility between the fund and the reference index. We further query how such principals could ever possibly be met for new funds. We believe these issues can be fixed by the CSA clarifying that the factors specified in the instructions of the Proposed Methodology for choosing a reference index are merely examples or suggestions of criteria, and by the CSA introducing less prescriptive wording in the factors.

Finally, we also seek clarity in the Proposed Methodology or instructions on whether multiple reference indices may be used for one fund. We note that there may be periods where one reference index more closely resembled the fund during a certain period, but either the mandate of the fund or the reference index itself changed so that it is not appropriate to use for the entire historical period. In addition, some reference indices that are most relevant for our funds do not themselves have a 10-year history.[2] In these instances, it would be helpful to be able to use multiple reference indices.

Use of Discretion to Increase a Risk Rating

As stated, we believe a fund manager should have the discretion to adjust the investment risk level of the fund, either higher (as now permitted) or lower, in certain circumstances. While we appreciate that the Proposed Methodology now permits the manager to increase the fund's risk level, we continue to stress the importance of allowing the manager the discretion to decrease the risk level of a mutual fund in particular instances.

For example, we offer mutual funds that use derivatives to decrease the volatility of a fund. However, most reference indices do not employ these strategies and may, as a result, incorrectly increase the investment risk level of the fund. As an example, Mackenzie US Low Volatility Fund seeks long term capital growth similar to the US equity market (its benchmark being the S&P 500), but with lower volatility. The fund invests in low-beta stocks, with the intent of capturing the low-beta anomaly and employs options strategies such as a collar strategy, which involves buying put options and selling call options with the intention of reducing volatility. These investment derivatives strategies, and particularly the latter one, cannot be represented by using a reference index. Using the S&P 500 as the reference index, this fund's risk rating would be "medium", however because the fund employs these strategies to achieve lower volatility, we believe the more appropriate investment risk level is "low-to-medium". In such circumstances, with additional disclosure in the Fund Facts and/or the prospectus, we think the manager should be allowed to decrease a risk level. Alternatively, we would urge the CSA to recognize in the Proposed Methodology or instructions its willingness to consider exemptive relief on a case-by-case basis for a manager to exercise discretion to lower a fund's risk level.[3]

Similarly, where a fund is on the cusp of two SD ranges, and the fund fluctuates between these two ranges, we believe the manager should also have the discretion to identify the more appropriate risk level (higher or lower) for that mutual fund.

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[2] For example, the reference index that is most highly correlates with our Mackenzie Investment Grade Floating Rate Fund is FTSE TMX Canada Floating Rate Note (FRN) Index, which has an inception date of June 30, 2011.

[3] We note similar guidance has been given in 81-102CP s 3.1(3) to NI 81-102.

Fundamental Changes

Where there is a reorganization, we are supportive of using the monthly return on investment of the continuing mutual fund.

Frequency of Determining the Investment Risk Level of a Mutual Fund

We support the proposal for fund managers to review the risk level at least annually during the renewal process. However, we seek clarification on whether the risks must be determined upon every filing of Fund Facts, for example, where there is an amendment that requires a change to the Fund Facts that is not related to the investment objectives. In such circumstances, we do not believe that the risk level of the fund should be reviewed.

Records of Standard Deviation Calculation

We are pleased the requirement to maintain records has been reduced from 10 years to seven years as this coincides with other securities statutory requirements for record-keeping.

Transition

We support the CSA's proposal to permit the transition to the Proposed Methodology at the time of the funds' renewal.

* * * *

Thank you for the opportunity to provide comments on the Proposed Risk Classification Methodology. Please feel free to contact the undersigned or Johanna Di Staulo at jdistaul@mackenzieinvestments.com or Nick Westlind at nick.westlind@mackenzieinvestments.com if you wish to discuss this further if you require additional information.

Yours truly,

MACKENZIE FINANCIAL CORPORATION

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President and Chief Executive Officer

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VIA EMAIL

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention: The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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Montréal (Québec) H4Z 1G3

Dear Sir/Madame:

Re: CSA Notice and Request for Comment – CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to National Instrument 81-102 *Investment Funds* and Related Consequential Amendments

Franklin Templeton Investments Corp. ("FTIC") welcomes the opportunity to make a submission with respect to the Canadian Securities Administrators ("CSA") Notice and

Request for Comment on Proposed Amendments to National Instrument 81-102 *Investment Funds* and Related Consequential Amendments (the "Proposed Amendments"), which mandate a CSA risk classification methodology (the "Proposed Methodology") for use by fund managers to determine the investment risk level of conventional mutual funds and exchange-traded mutual funds for disclosure in the Fund Facts document ("Fund Facts") and in the ETF Facts document.

FTIC is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin, Templeton, Franklin Bissett, Franklin Mutual Series, and Franklin Quotential funds and institutional accounts. In Canada, FTIC has more than 500 employees providing services to nearly 500,000 unitholder accounts and over 100 pension funds, foundations and other institutional investors.

FTIC supports a mandated, standardized risk classification methodology as this would ensure uniform and consistent risk disclosure amongst mutual funds, which would make comparing funds easier and more meaningful for investors. However, we do have some concerns with the Proposed Methodology, which include: (1) the use of discretion to increase the investment risk level of a mutual fund; (2) methodology issues related to the use of a reference index and the lack of ability to use other proxies for mutual funds with less than 10 years of history; and (3) disclosure issues related to the use of a reference index.

The use of discretion to increase the investment risk level of a mutual fund

The Proposed Methodology allows a fund manager to increase the investment risk level of a mutual fund "if doing so is reasonable in the circumstances". FTIC agrees that fund managers should be able to exercise this limited amount of discretion over fund investment risk levels provided that: (1) fund managers adopt written policies and procedures that set out the circumstances under which a fund investment risk level may be raised; and (2) fund managers disclose to investors, preferably in the Fund Facts, that the investment risk level of the fund has been increased over the level dictated by the fund's standard deviation.

Because allowing fund managers to increase a fund's investment risk level introduces an element of judgement or discretion to the fund risk classification process, FTIC believes that it would be appropriate for the CSA to provide clarification of the phrase "reasonable in the circumstances". Providing additional detail on the circumstances in which the CSA considers that it may be reasonable for fund managers to raise a fund's investment risk level would reduce or eliminate the discretion to be applied by fund managers and would be helpful to fund managers in crafting written policies and procedures in this area.

While a fund manager must keep and maintain records that document why it was reasonable to increase the investment risk level of a mutual fund, an investor comparing Fund Facts for two different funds will not know if a fund manager has exercised its discretion to increase the risk rating of a fund, and thus may select a mutual fund based on incomplete information. Requiring fund managers to disclose circumstances when discretion over fund investment risk level was exercised in the Fund Facts would make comparing mutual funds easier and more meaningful to investors.

Methodology issues related to the use of a reference index and the ability to use other proxies for mutual funds with less than 10 years of history

The Proposed Methodology requires fund managers to select a reference index that reasonably approximates the "return on investment" of any mutual fund that has less than 10 years of performance history. Many funds do not have 10 years of performance history, which would require the fund manager to use reference indices as a proxy for fund returns for a significant period of time. While FTIC agrees with certain of the reference index selection guidelines outlined in the Proposed Methodology, we note that the guidelines will prove problematic to apply in the case of new funds and funds that do not invest in a manner that has a high degree of correlation to a reference index. In these two situations, we believe it will be difficult to select a reference index that: (1) has returns highly correlated to the returns of the fund; (2) contains a high proportion of the securities represented in the fund's portfolio with similar portfolio allocations; (3) has a historical systematic risk profile similar to the fund; and (4) has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets. We believe that using a reference index with little or no correlation to fund performance could be confusing or misleading to investors.

Given the issues surrounding the use of a reference index, we believe that for funds with less than 10 years of performance, the Proposed Methodology should allow a fund manager to use either a clone fund or a Sister Fund (defined below) as proxies for determining fund risk.

We note that in the "Comment on the 2013 Proposal" table, the CSA has indicated that where an underlying fund has a 10 year history and the top fund's investment objectives and strategy is to "clone" the underlying fund, staff may consider allowing, through exemptive relief, the use of the underlying fund's volatility of returns for the purposes of determining the top fund's investment risk level. We are encouraged that the CSA has acknowledged that funds invested, directly or indirectly, in the same pool assets should have consistent volatility risk calculations. However, we believe that the Proposed Methodology should specifically allow top funds that meet the definition of "clone fund" under NI 81-102 to use the underlying fund's volatility of returns for the purposes of determining the clone fund's investment risk level without having to seek exemptive relief. Such an approach would be consistent with how clone funds are dealt with in sections 2.5 and 10.6 of NI 81-102.

Furthermore, we believe that the CSA should permit the ability to use Sister Funds as proxies for mutual funds with less than 10 years of performance. FTIC offers a number of mutual funds in Canada that are the same or very similar in strategy to funds offered by Franklin Templeton Investments in other parts of the world under the Undertakings for Collective Investments in Transferable Securities ("UCITS") directives (the "Sister Funds"). These Sister Funds have the same portfolio manager, investment objective and strategies as the applicable Canadian fund. In addition, because the Sister Funds are distributed in accordance with the UCITS directives, they are subject to investment restrictions and practices that are substantially similar to those that govern the Canadian funds. We believe that a Canadian fund with less than 10 years of history should be permitted to use its Sister Fund's volatility of returns for the purposes of determining the Canadian fund's investment risk level, provided that the Sister Fund: (1) has a 10 year performance history; (2) is subject to the UCITS directives and (3) has the same portfolio manager, investment objectives and strategies as the Canadian fund. The Sister Fund's volatility of returns would provide a better proxy for understanding the risk of a fund than the volatility of returns of a reference index. We recommend that the CSA allow the use of the Sister Fund's volatility of returns until the new Canadian fund has sufficient performance history of its own.

Where a clone fund or a Sister Fund is not available, rather than wholly replacing a mutual fund's standard deviation metrics with those of a reference index, FTIC believes the approach suggested by the CSA in Notice 81-324 and Request for Comment on the *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the "2013 Proposal"), which contemplated fund managers using a reference index to impute missing fund data is a more accurate approach. In the 2013 Proposal, there was specific reference to the ability to use actual fund returns as far back as available but to then link fund returns to reference index returns to backfill missing fund returns from periods prior to fund inception. This reference is missing from the Proposed Methodology.

In our view, wholly replacing missing fund data with data from a reference index without linking fund returns to reference index returns is problematic, except in the case of index funds or ETFs that seek to replicate a specific index. In these instances, the reference index would be representative of the fund's returns and therefore the particular fund's volatility risk. In all other cases, however, a reference index will not be truly representative of the style of the portfolio manager for a given fund. This discrepancy would impair the usefulness of the risk classification as a reflection of the actual fund's volatility risk.

Given the issues surrounding the use of a reference index, where a clone fund or Sister Fund is not available as a proxy for a new fund's returns, FTIC urges the CSA to reconsider a five year period for standard deviation calculation or to revert to the 2013 Proposal for this aspect of the methodology, where linking to a reference index for periods prior to inception was specifically mentioned.

Disclosure issues related to the use of a reference index

Currently, the only disclosure document in which fund managers are required to compare fund performance to an index is the fund's management report of fund performance ("MRFP"). The Proposed Methodology requires that a fund with less than 10 years of performance history must select a reference index that "reasonably approximates the 'return on investment' of the fund" and provides some guidance on the selection criteria for the reference index. The Proposed Methodology requires that a brief description of any reference index used as proxy be disclosed in the simplified prospectus. The sales communication requirements in National Instrument 81-102 *Investment Funds* ("NI 81-102") generally require that sales communications be consistent with the simplified prospectus, annual information form and Fund Facts. Accordingly, for any fund with less than 10 years of history, any reference index used in sales communications would need to match the reference index disclosed in the simplified prospectus.

However, due to the differences in the index selection guidelines contained in Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* ("Form 81-106F1"), the reference index disclosed in the prospectus and used in sales communications may not match the benchmark index in the MRFP.

Section 4.3(2) of Form 81-106F1 requires that fund managers compare fund performance to the historical annual compound total returns or changes of:

(a) one or more appropriate broad-based securities market indices; and

(b) at the option of the fund, one or more non-securities indices or narrowly-based market indices that reflect the market sectors in which the fund invests.

Form 81-106F1 defines "appropriate broad-based securities market index" as an index that

(a) is administered by an organization that is not affiliated with the any of the mutual fund, its manager, portfolio adviser or principal distributor, unless the index is widely recognized and used; and

(b) has been adjusted by its administrator to reflect the reinvestment of dividends on securities in the index or interest on debt.

The definition in Form 81-106F1 to select a benchmark index for the MRFP is much less specific than the selection criteria set out in the Proposed Methodology to select the reference index and could lead to the use of two (or more) different indices in the various disclosure documents of the same fund. This inconsistency would be confusing to investors. Furthermore, attempting to make sales communications consistent with both the MRFP and the prospectus by reflecting both the MRFP benchmark and the 81-102 reference index would likely only compound investor confusion.

FTIC urges the CSA to revisit all index selection and disclosure requirements applicable to mutual funds and make them consistent with each other.

Thank you for your consideration of this submission. Please feel free to contact me at 416.957.6010 or my colleague, Ariane Farrell, at 416.957.6089 should you have any questions or wish to discuss our submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

Brad Beuttenmiller

Brad Beuttenmiller
Senior Associate General Counsel

Investors Group™

MURRAY J. TAYLOR
President and Chief Executive Officer

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
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22nd Floor
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: CSA Mutual Fund Risk Classification Methodology for use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments

---

We are writing to provide our comments on the Canadian Securities Administrators (CSA) proposed mutual fund risk classification methodology for use in Fund Facts and ETF Facts (the Proposed Methodology).

Investors Group Inc. (Investors Group) is a diversified financial services company and one of Canada's largest managers and distributors of mutual funds, with assets under management of over $74 billion at December 31, 2015. Investors Group distributes its products through approximately 5300 Consultants engaged with its subsidiaries, Investors Group Financial Services Inc and Investors Group Securities Inc., which are members of the MFDA and IIROC, respectively.

We agree with the statement in the introduction to the Proposed Methodology that a standardized risk classification methodology will be more useful to investors, as it will provide a consistent and comparable basis for measuring the risk of different mutual funds. We also support the seven criteria and objectives set out in the Introduction to Annex A published previously in CSA Notice 81-324 (the 2013 Proposal).[1]

General Comments

We thank you for the opportunity to comment on the Proposed Methodology. We are pleased with many of the key changes made to the 2013 Proposal and appreciate the CSA's responsiveness to the comments made. Specifically, we support:

- the retention of the five-category scale currently prescribed in the Fund Facts and proposed ETF Facts,
- the adoption of the standard deviation (SD) ranges currently used in the IFIC Methodology,
- the allowance of fund manager discretion to increase the investment risk level of a mutual fund,
- the application of the Proposed Methodology to ETFs,
- changing the frequency of determining the investment risk level of a mutual fund from monthly to at least annually, upon the filing of a Fund Fact or ETF Facts, and,
- reducing the period to maintain records of the determination of the investment risk level of a mutual fund from 10 years to 7 years.

Overall we believe this updated approach will be very useful and generally appropriate. However, we do have some important suggestions for you to consider before finalizing the Proposed Methodology. It is with the CSA's criteria and objectives set out in the 2013 Proposal in mind that we provide our comments on the Proposed Methodology.

Periodic Review of the Standard Deviation Ranges

The Proposed Methodology does not make any provision for the review and possible adjustment of the SD ranges in order to take into account general market volatility.

The CSA specifies that a key objective is for the methodology to be "...a stable indicator of risk while fairly reflecting market cycles and broad market fluctuations". The attached graph in Appendix A illustrates the historical fluctuations in general market volatility levels. The 10 year rolling SD of the S&P TSX Composite, S&P 500 and MSCI EAFE have been graphed against a back drop of the current IFIC Methodology risk classification SD ranges. These indices are good proxies for the volatility of broadly diversified mutual funds that invest in the markets these indices represent.

Currently, the Investment Funds Institute of Canada (IFIC) reviews its risk classification methodology (the IFIC Methodology) annually through a risk classification task force. Without a mechanism to review and adjust the SD ranges to ensure they remain relevant with current market trends and volatility, risk levels of mutual funds will have to be reclassified unnecessarily, causing unnecessary disruption and confusion to investors.

We strongly encourage the CSA to adopt in the Proposed Methodology a periodic review of the volatility of market indices to identify periods of unusually high or low volatility and adjust the SD ranges, as necessary, to achieve the CSA's objective for the Proposed Methodology to fairly reflect market cycles and broad market fluctuations. We believe it would be beneficial if the CSA conducts this review in collaboration with an industry advisory committee.

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[1] CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (December 12, 2013).

Fund Manager Discretion to Decrease a Mutual Fund's Risk Level

In the absence of the Proposed Methodology including a regular review and any necessary adjustments in the SD ranges, we believe discretion should be given to the fund manager to both decrease, as well as increase, the investment risk level of a mutual fund to avoid the unnecessary disruption and confusion for investors that would be caused by a reclassification due to general market conditions and fluctuations in market volatility levels. Some qualitative limitations could be made on situations that would justify reductions implemented by the fund manager in a fund's risk rating.

We think allowing the fund manager the discretion to decrease a mutual fund's risk level in such circumstances is consistent with the manager's statutory duty to act in the best interests of the mutual fund in instances where the manager has determined that a lower risk level would better reflect the volatility of the mutual fund.

The Use of a Reference Index

The CSA cites as a criteria for the methodology that it be "... relatively simple and cost-effective for fund managers to implement".

We support the CSA's approach of using a reference index as a proxy in the Proposed Methodology in instances where a mutual fund has less than 10 years of performance history. We agree with the language of the methodology, that "the mutual fund must select a reference index that reasonably approximates the "return on investment" of the mutual fund".

The instructions for the selection and monitoring of the reference index, however, describe factors that a mutual fund "should consider". We find the description of the factors to require a level of analysis that would be impracticable in some circumstances and onerous and, potentially, expensive in others. As a result, the current instructions in the Proposed Methodology on the factors to consider in choosing a reference index do not align with the CSA's stated objective.

For example, the instructions state that among the factors that a mutual fund **should consider** in choosing a reference index is whether the index "contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations". This particular instruction would require index constituent data that may not be readily available and may be expensive to obtain. It would also be extremely cumbersome in the case of a fund for which a blend of indices is selected as the reference index.

In the case of new mutual funds for which there is no actual performance data it would not be possible to conduct much of the analysis called for in the instructions, such as, "has returns highly correlated to the returns of the market". As well, in spite of the wide range of indices available, for an innovative strategy, a very specific strategy, or a strategy allowing significant manager discretion with respect to asset class or geographic asset allocation, it may not be possible to complete the analysis in order to identify a reference index (or blend of indices) that is as highly similar as the proposed instructions require.

Accordingly, if the factors specified in the instructions of the Proposed Methodology for choosing a reference index are retained, we ask that the CSA clarify that they are simply examples of criteria fund managers can consider.

Standardized time frame

The CSA specifies that among the key objectives for the methodology is that it be "uniform", "easily understood" and "...allow for easy comparison across funds". To achieve this, we recommend the CSA require that the time period of data used in calculating the Proposed Methodology be as of the most recently completed calendar year.

We believe standardizing the time frame in this way would serve three purposes:

- the time period on which the risk level is based would then be the same as the 10 year calendar year performance displayed graphically on the Fund Facts,
- the risk level for all Fund Facts filed by managers in a given year would be based on the same 10 year time period, and
- if an annual review of the risk level SD ranges is incorporated in the Proposed Methodology, which we would strongly advocate for, the analysis and any changes to a fund's risk level could also be based on the calendar year end.

Fundamental Changes

Finally, we support the inclusion in the Proposed Methodology of how to determine a fund's risk level in the event of a fundamental change. However, we find the wording in the Proposed Methodology unclear and would suggest that the section be revisited. We recommend that the instruction clarify that the manager must determine if the fund's previous performance is still relevant to the expected risk level of the fund subsequent to the fundamental change. If the change to the fund is such that the fund's history is not relevant, the manager needs to select a reference index to use in the place of the fund's previous performance data.

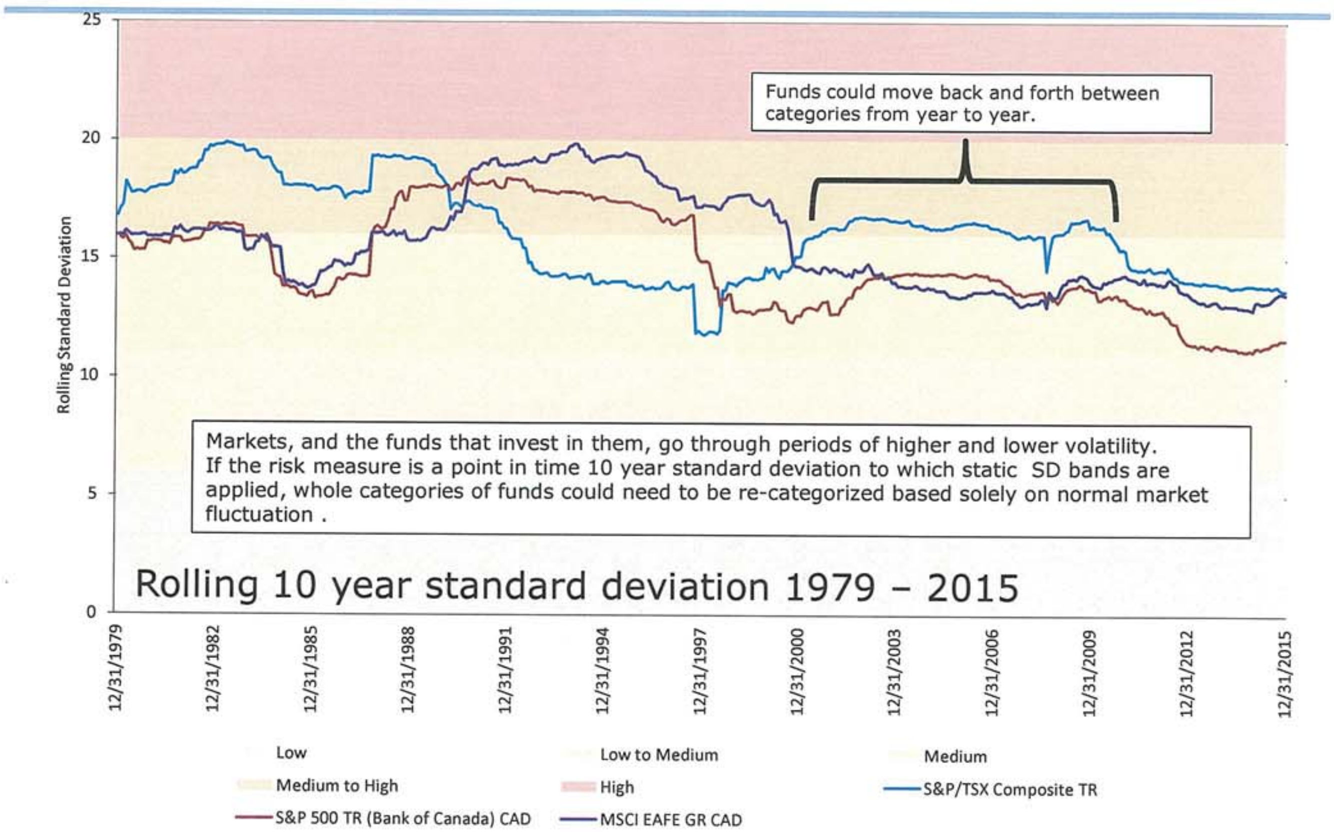
Thank you for the opportunity to provide comments on the Proposed Methodology. Please feel free to contact the undersigned or Scott Elson (scott.elson@investorsgroup.com) or Sandra Sigurdson (sandra.sigurdson@investorsgroup.com) if you wish to discuss or if you require additional information.

Yours truly,

INVESTORS GROUP INC.

Murray J. Taylor
President and Chief Executive Officer

Appendix A



Investors Group

Source: Morningstar Direct

Alternative Investment Management Association (AIMA)

The Forum for Hedge Funds, Managed Futures and Managed Currencies

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Series Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Me Anne-Marie Beaudoin
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22nd Floor
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Comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Notice and Request for Comments - CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts (the "Proposal")

This letter is being written on behalf of the Canadian section ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the legislation referred to above.

Although the Proposal does not directly impact our members who do not manage mutual funds and exchange traded funds in addition to alternative funds, we are providing our comments given the potential future application of the Proposal to Modernization of Investment Fund Product Regulation – amendments to National Instrument 81-104 *Commodity Pools* (the "Alternative Funds Framework").

The predecessor of the Proposal was published on December 12, 2013 by the CSA in CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the "2013 Proposal"). At the time, AIMA Canada submitted a comprehensive comment letter in response to the various questions posed under the 2013 Proposal. Now, as securities regulators are working towards publishing an instrument implementing the Alternative Funds Framework, the future effect of the Proposal on alternative funds should be carefully considered.

In addition, the Proposal could have more immediate implications on our members who may choose to adopt the Proposal methodology in their private funds even though they are not required to do so.

About AIMA

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in hedge fund, futures fund and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises over 1,600 corporate members in more than 50 countries, including many leading investment managers, professional advisers and institutional investors. AIMA Canada, established in 2003, now has more than 130 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of hedge funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member. Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount exemptions. Manager members also have multiple

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registrations with the securities regulatory authorities: as Portfolio Managers, Investment Fund Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our web sites at canada.aima.org and www.aima.org.

Summary and Overview

We acknowledge and appreciate the CSA's recognition of the desirability of establishing a standardized risk classification methodology to facilitate investor comparisons of the risks of investing in different mutual funds and alternative funds. We also believe that using reference indices when performance history does not exist is generally a good idea. However, imputing returns based on a reference index is by nature an imperfect exercise and it is important to be aware of the limitations of such an approach. We see the following issues in applying the Proposal, and specifically the use of reference indices, to the Alternative Funds Framework:

1. There may be no relevant reference indices for certain actively managed strategies that are highly dependent on decisions of individual fund managers (e.g. merger arbitration, equity market neutral).
2. Seemingly applicable indices comprised of funds with similar strategies may be misleading.
3. It may not be possible for funds with certain actively managed strategies to comply with all the principles for selecting a reference index specified by the CSA.
4. In most cases there will be no performance history when the Alternative Funds Framework is launched.
5. The 10-year timeframe required to assess risk is too long.

These issues are expanded upon below along with suggestions for adaptation to the Alternative Funds Framework.

1. Some alternative investment funds may have no relevant reference index

We see there being three different categories of fund strategies, with the first two being amenable to reference indices and the third not.

First, there are rules-based strategies that can be easily back-tested (such as index-tracking funds and passive exchange traded funds). Second, there are simple active management strategies that consist of choosing which assets from a certain sector or geographic area to buy and hold (actively managed long only funds). While these strategies cannot be back-tested, an index that represents a certain asset class within a sector or geographic area can serve as a rough proxy. This is because traditional mutual fund managers choose which assets to buy and hold from the asset class or geographic region in which they have chosen to invest. Since they must choose a large enough number of these assets in order to be properly diversified, the portfolio returns end up somewhere close to their relevant reference index.

The third category of strategies are complex active management strategies for which the day-to-day decisions of individual fund managers are the dominant influences on returns (e.g. merger arbitration, equity market neutral, long/short equity, commodities trading advisors ("CTAs") etc.). Most alternative investment funds will fall into this third category. These types of strategies cannot be back-tested and also likely have no appropriate index that could serve as a proxy for their performance. This is because the returns of alternative investment funds will not have the same relationship to a certain pool of assets like a conventional mutual fund. Strategies of alternative investment funds are generally highly dependent on the decisions of the individual fund managers. While all of the assets they decide to trade may come from a certain pool, the average return of their holdings will not bear any significant resemblance to the average return of the pool.

The only type of index that could potentially be relevant for alternative investment funds in this third category is an index comprised of other funds with substantially similar strategies (a "Similar Funds Index"). However, as described below, these types of indices have several problems that compromise their effectiveness.

2. Seemingly applicable indices may be misleading

Even if there exists a seemingly applicable Similar Funds Index for an alternative mutual fund, the index itself is likely to be uniquely problematic in a way that reference indices for conventional mutual funds are not.

First, the dataset for some Similar Funds Indices is too small to be statistically significant. For example, the Scotiabank CTA index is comprised of only five funds.

Second, some relevant Similar Funds Indices (for example, the Scotiabank group of hedge fund indices) are only made up of funds that volunteer to be included. This creates selection bias, as both top-performing funds and bottom-performing funds will often not volunteer their data for the index. The ultimate volunteers are more likely to be middle-performing funds, which will result in a smoothing of the index and therefore an inaccurate proxy for risk.

Finally, and most importantly, there is too much dispersion of individual fund performance around the performance of the Similar Funds Index. Even within a particular strategy, returns may be completely uncorrelated between different sub-strategies (such as merger arbitration in the pharmaceutical sector versus the energy sector or such as between equity market neutral in Canada versus emerging markets). Many alternative investment funds pursue very niche sub-strategies and there are simply not enough funds engaged in each sub-strategy to create meaningful targeted Similar Funds Indices.

Given these limitations, we discuss recommendations in the following three sections below.

3. Difficulty Complying with the CSA's Reference Index Principles

The Proposal indicates that a fund manager should choose a reference index that meets the following principles:

(a) is made up of one or a composite of several market indices that best reflect the returns and volatility of the mutual fund and the portfolio of the mutual fund;
(b) has returns highly correlated to the returns of the mutual fund;
(c) contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations;
(d) has a historical systemic risk profile highly similar to the mutual fund;
(e) reflects the market sectors in which the mutual fund is investing;
(f) has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets;
(g) is denominated, in or converted into, the same currency as the mutual fund's reported net asset value;
(h) has its returns computed on the same basis (e.g., total return, net of withholding taxes, etc.) as the mutual fund's returns;
(i) is based on an index or indices that are each administered by an organization that is not affiliated with the mutual fund, its manager, portfolio manager or principal distributor, unless the index is widely recognized and used; and
(j) is based on an index or indices that have each been adjusted by its index provider to include the reinvestment of all income and capital gains distributions in additional securities of the mutual fund.

It may be difficult or impossible for alternative investment funds with certain actively managed strategies to satisfy *all* of these principles.

For example, principles (b) and (d) above relate to the correlation of fund returns to index returns. As described above, certain actively managed strategies are executed by different fund managers in such diverse ways that there will be no significant correlation between the fund returns and the returns

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of a Similar Funds Index. The most obvious example of this issue is a CTA strategy, which may use derivatives in a completely different way from another CTA strategy fund while still being grouped together with that fund in a Similar Funds Index.

For example, principles (c) and (f) above relate to the portfolio allocations of the fund versus the portfolio allocations in the index. However, in the case of a Similar Funds Index, portfolio allocations for such an index will likely not be available as the individual funds which comprise the index will not volunteer such information. Therefore, fund managers may not have sufficient information to comply with principles (c) and (f) when choosing a Similar Funds Index as a reference index.

We recommend that where certain principles from the list are difficult or impossible to satisfy, a carve-out exemption from such principles should be considered by the CSA in relation to the Alternative Funds Framework.

In addition, the CSA indicated that blended indices could be used to create a reference index. We submit that it would be helpful if the instructions in the final rule would clarify that indices could be blended on both an asset-weighted basis (e.g. 70% weight on a equity index and 30% weight on a bond index) and a temporally-divided basis (e.g. switching from one index to another when the first index no longer exists). This would assist alternative investment funds in satisfying the CSA's reference index principles.

4. No performance history when Alternative Funds Framework is launched

Once the Alternative Funds Framework is introduced, the alternative investment funds that emerge will in most cases have no performance history. This will mean that, in the absence of an exception, these new alternative investment funds will have to rely solely on reference indices to determine their risk rating.

In practice, a large number of these new alternative investment funds will be launched by fund managers who already manage investment funds using substantially similar strategies that are offered through an offering memorandum ("OM Funds"). We believe that a new alternative investment fund should be able to use a related OM Fund's previous performance history to calculate its risk rating if the OM Fund has the same manager and substantially the same strategy. This will provide a much more accurate proxy of risk than relying on a reference index.

5. The 10-year timeframe required to assess risk is too long

We submit that a 10-year period of performance required to assess risk is too long. New alternative investment funds will have either no performance history

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or, if our suggestion regarding related OM Fund history is taken into account, only a few years of performance history.

While using a reference index to fill in the performance gaps for mutual funds under the Proposal already presents difficulties, these difficulties are magnified significantly when reference indices are applied to alternative investment funds without any track record. See the section above titled "Seemingly applicable indices may be misleading".

In the case of most alternative investment funds, we believe that the less a reference index is used, the more accurate the risk rating will be. Therefore, we recommend shortening the mandatory performance history period to the greater of 5 years and the actual number of years the fund has been in existence (taking into account the performance history of related OM Funds). We note that the CESR Guideline for UCITS funds requires only a 5-year period.

Conclusion

In summary, we agree with the CSA's objective of establishing a standardized risk classification methodology to facilitate investor comparisons of the risk of investing in different mutual funds. However, since certain actively managed strategies may not have a relevant or reliable reference index, we note the following points and recommendations regarding the potential future application of the Proposal to the Alternative Funds Framework:

- Since it may not be possible for alternative investment funds with certain actively managed strategies to satisfy certain of the reference index principles, the CSA should consider a carve-out exemption from such principles in relation to the Alternative Funds Framework.
- Since new alternative investment funds will have no performance history when the Alternative Funds Framework is launched, we submit that these new alternative investment funds should be able to use a related OM Fund's previous performance history to calculate their risk rating if the OM Fund has the same manager and substantially the same strategy.
- Given the anticipated lack of performance history for new alternative investment funds and the issues with using a reference index for certain actively managed strategies, the 10-year time period required to assess risk is too long. We recommend a 5-year time period.

We appreciate the opportunity to provide the CSA with our views on the Proposal. Please do not hesitate to contact the members of AIMA set out below with any comments or questions that you might have.

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Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

Ian Pember
On behalf of AIMA Canada and the Legal & Finance Committee

FAIR
Canadian Foundation *for* Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

March 9, 2016

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The Secretary
Ontario Securities Commission
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Sent via e-mail to: comments@osc.gov.on.ca

RE: Request for Comment: CSA Mutual Fund Risk Classification Methodology

---

FAIR Canada is pleased to offer comments on the CSA Notice and Request for Comment regarding the proposed CSA mutual fund risk classification methodology for use in Fund Facts and ETF Facts (the "Notice").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. Executive Summary

1.1. FAIR Canada supports mandating a standardized methodology for the risk ratings of mutual funds and ETFs but believes that changes to the Proposed Methodology are necessary. Changes must ensure that investors (and advisors) are not misled about the risks of an investment fund before they decide to invest.

1.2. Given our understanding of what matters to investors and the document testing that was conducted with investors, changes are necessary.

1.3. FAIR Canada urges the CSA to live up to international best practices and principles with respect to disclosure of risk. We also make specific recommendations regarding other proposed changes to the Proposed Methodology.

1.4. Finally, we believe that summary documents should be expanded to other investment products such as structured products and alternative investment funds. Fund Facts risk disclosure should be designed now so as to take into account other investment products that should also be subject to summary disclosure, so that meaningful comparisons can be made.

2. **FAIR Canada Supports the CSA in Mandating a Standardized Methodology for the Risk Rating**

2.1. FAIR Canada continues to support the introduction of a CSA mandated risk classification methodology (the "Proposed Methodology") rather than allowing each fund manager to have the discretion to use its own methodology for disclosure in Fund Facts. The use of a prescribed methodology is a step forward as it will allow for transparency[1], consistency and the ability to compare products through Fund Facts.

2.2. If the Proposed Methodology is adopted as guidance rather than mandated, it may not facilitate comparability between funds.

3. The Proposed Disclosure for Risk is Incomplete – More than Volatility Risk Needs to be Disclosed on Fund Facts

3.1. There is broad agreement that investment risk is not confined or limited to volatility risk. Therefore, the "How risky is it?" section of Fund Facts should not be limited to describing volatility. If it does, it will seriously limit the usefulness of this document for those who use and rely on it - investors and their advisors/dealers. Moreover, to limit this section to volatility risk may also mislead investors and advisors/dealers as to the risks involved with investing in the fund.

3.2. IOSCO's Sound Practices for Investment Risk Education Final Report defines "investment risk" to be "...the risk that an investment will not deliver the expected yield and/or lose value. This concept is applied broadly in the report and taken to include a variety of risks such as:

- Volatility risk;
- Capital risk;
- Liquidity risk;
- Inflation risk;
- Credit risk; and
- Interest rate risk."[2]

[1] As noted in CSA Notice 81-324, "In addition to consistency, we think that the use of a standard methodology will enhance transparency in the market by enabling third parties to independently verify the risk rating disclosure of a mutual fund in the Fund Facts"; CSA Notice 81-324 (2013), 36 OSCB 11849 at 11850, available online at https://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20131212_81-324_rfc-mutual-fund-risk.pdf

[2] IOSCO's Sound Practices for Investment Risk Education Final Report, (September 2015), at page 3; available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD505.pdf.

3.3. FAIR Canada is of the view that disclosing only one type of risk in Fund Facts is flawed. The CSA has not provided an adequate explanation for why it would not follow the principles and best practices of the International Organization of Securities Commissions ("IOSCO"), including IOSCO's Principle 1[3], which requires that "[r]isk disclosures should include the material risks for the product". If a scale is considered appropriate to identify the overall risk measurement or classification of the product, then this needs to be supplemented by: (a) a narrative explanation of the indicator and its main limitations; and (b) a narrative explanation of risks which are materially relevant.... and which are not adequately captured by the synthetic indicator.[4]

3.4. At present, the Proposed Methodology would result in the presentation of a graph in Fund Facts where the volatility risk falls within one of five categories (low, low-to-medium, medium, medium-to-high, and high) and provides a narrative explanation for the indicator (i.e., volatility risk) as follows:

> "One way to gauge risk is to look at how much a fund's returns change over time. This is called "volatility". In general, funds with higher volatility will have returns that change more over time. They typically have a greater chance of losing money and may have a greater chance of higher returns. Funds with lower volatility tend to have returns that change less over time. They typically have lower returns and may have a lower chance of losing money."

No narrative explanation of the indicator's limitations accompanies this statement, nor does it set out or explain risks which are *materially relevant but are not adequately captured by volatility risk (the indicator)*. It just refers readers to the simplified prospectus if they want more information:

> "For more information about the risk rating and specific risks that can affect the fund's returns, see the Risk section of the fund's simplified prospectus".

The Fund Facts does not tell readers that volatility risk *does not take into account or adequately take into account other risks that are present* when investing in the fund (or, if volatility risk does take those other risks into account, the document does not indicate that it does so). Therefore, the risk section of Fund Facts is inadequate and misleading.

3.5. The template for the Key Investor Information Document[5] (or "KIID") contained in the Committee of European Securities Regulators (CESR), now the European Securities and Markets Authority (ESMA), does have a narrative explanation of the indicator and its main limitations. The rating is on a scale of 1 to 7 rather than 5 as is now proposed by the CSA (originally 6) and contains a section "Narrative explanation of the indicator and its main limitations" which includes an explanation of "Why the fund is in its specific category" and that "The lowest category does not mean 'risk free'".

3.6. The KIID also includes a narrative explanation of the risks which are materially relevant and

[3] IOSCO Principles on Point of Sale Disclosure, Final Report, (February 2011), at page 28.
[4] IOSCO Principles on Point of Sale Disclosure, Final Report, February 2011 at page 28, and at footnote 31.
[5] CESR's template for the Key Investor Information Document (July 20, 2010); available online at: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_794.pdf.

which are not adequately captured by the synthetic indicator. It has a "narrative presentation of risks materially relevant to the fund which are not adequately captured by the indicator."

3.7. In order for investors to make informed investment decisions, in order to assist advisors help explain the material risks of the fund to their clients and in order to not mislead investors and advisors, it is necessary that the "How Risky is it?" section of the Fund Facts indicate the volatility risk of the fund in a way that is comparable to other funds *while also providing (a) a narrative explanation of the limitations of the volatility indicator and (b) the material risks of the fund not captured by volatility risk.*

3.8. **FAIR Canada strongly recommends that the "How Risky Is it?" section of Fund Facts must include more than volatility risk so that investors can understand the risks associated with the fund. This is essential in order to properly compare funds (which one needs to do) in order to make an informed investment decision. Investors must know the limitations of the indicator (the scale used) and be provided with a description of the material risks not adequately captured by the indicator. Investors in Europe are provided with this information in the KIID. Why would we not adhere to this international best practice and standard in Canada?**

4. Investor Testing and Investor Behaviour Supports Including Material Risks in Addition to Volatility Risk

4.1. The CSA sponsored document testing with investors of the Fund Facts document in 2012. The testing was done with a version of Fund Facts that contained a list of "other specific risks" – a proposed requirement to list no more than four main risks of the fund. The quantitative research involved 532 online respondents across Canada from a random sample of 1603 Canadians. The quantitative testing found:

- Half (50%) of all mutual fund investors are not very or not at all clear about what other specific risks are.[6] The lack of understanding, not surprisingly, increases with a decrease in level of investment knowledge.

- 83% of the investors, nonetheless, wanted to keep the section "other specific risks" but have Fund Facts contain a brief explanation of each of the specific risks listed; 14% wanted to keep the "other specific risks" section just as it is while 3% wanted to drop the section.[7]

- The most frequently offered suggestion to improve the risk section of Fund Facts is to provide explanations of the other types of risks.[8]

- When asked to choose one or more actions they would take before purchasing the mutual fund (from a list of actions), 70% of investors said they would ask their advisor to explain the risk of the funds to them, 50% would read the simplified prospectus to learn about all

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6 CSA Point of Sale Disclosure Project: Fund Facts Document Testing prepared by Allen Research Corporation (September 2012) at page 70; available online at https://www.osc.gov.on.ca/documents/en/InvestmentFunds/pos_201209_fund-facts-doc-testing.pdf

7 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 71.

8 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 74. 17% of investors offered this suggestion to improve this section.

of the risks of the fund, 34% would look for more information about mutual fund risks on the internet and 26% said they would only read this Fund Facts document carefully to learn as much as they need to know about this fund's risks.[9]

The qualitative testing of investors involved 21 one-on-one, in-depth, one hour interviews. Many of the investors invested through an advisor and a few did their own investing. The interviews elicited the following:

- Many learn about the investment vehicle and purchase it on the advice of their advisor in the same meeting. "The information their adviser gives them is paramount and trust is a key part of the decision process."[10]

- The risk section "seems cluttered, textually dense, and required repeated reading to understand".[11]

- The labels on the x-axis -typically lower returns and less chance of success" and "typically higher returns and greater chance of success" – were described as very clear.[12]

- Investors were frustrated by the lack of explanation of the specific risks and did not want to have to look up the meaning or go to the simplified prospectus to find out.[13]

4.2. FAIR Canada is of the view that these findings strongly support revising the "How risky is it?" section of Fund Facts. However, the changes the CSA made went in a direction opposite to what was learned from the testing of the document with investors. In particular, the CSA:

- Deleted the specific risks listed rather than provide a narrative explanation of the specific risks.

- The CSA changed the sentence: "For a full list of *this fund's risk factors and details about them* see the Risk section of the fund's simplified prospectus" to "For more information about the risk rating and *specific risks that can affect the fund's returns*, see the Risk section of the fund's simplified prospectus." (emphasis added)

4.3. Investors and their advisors are unlikely to go to the simplified prospectus because:

- There is no language in the "How risky is it? section of Fund Facts that alerts the investor or advisor to the fact that the risk section does not include other material risks not captured by volatility risk (the risk scale).

- Few investors read and understand the simplified prospectus, as the CSA has itself stated: "[w]e know that many investors do not use the information in the simplified prospectus

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9 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 72.
10 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 29. See also page 30 for specific comments which demonstrate high degree of reliance and trust on the advisor.
11 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 33.
12 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 37.
13 CSA Point of Sale Disclosure Project: Fund Facts Document Testing at page 38.

because they have trouble finding and understanding the information they need."[14]

- Investors also no longer receive a copy of the simplified prospectus when they invest in the fund. They have to ask separately for it.

- Focus group testing found that many learn about the investment vehicle and purchase on the advice of their advisor in the same meeting. There will likely not be sufficient time to read through the list of risks in the simplified prospectus.

4.4. In addition, the simplified prospectus will not alert the investor or advisor to the key or material risks but will rather provide them with a long list of all possible risks associated with the investment.

4.5. Given that securities regulators would not provide a receipt for a simplified prospectus if it only included volatility risk and not other material risks, the Fund Facts should also not be limited to volatility risk.

4.6. In addition, the CSA removed the labels on the x-axis –"typically lower returns and less chance of success" and "typically higher returns and greater chance of success" and substituted more text to describe the graph despite investors finding this clear.

4.7. **FAIR Canada strongly recommends that the CSA properly account for the investor testing results and revise the "How risky is it?" section accordingly**. **The material risks not covered by volatility risk should be put in the section with a narrative explanation.** This is what is done in the KIID.

4.8. FAIR Canada also notes that, given existing technology, the Fund Facts could be designed so the narrative explanation of the material risks are found in embedded links. This could be done in a manner that provides a simple explanation or a more detailed and sophisticated explanation, available at the option of the specific individual or advisor.

4.9. Our concerns are not addressed by the CSA's proposal to allow the use of discretion to classify a mutual fund at a higher investment risk level. The CSA has provided discretion to move the fund up the risk scale but not an obligation to do so. Moreover, while a higher risk level may better reflect the effect of "qualitative factors in addition to the quantitative calculation in determining the investment risk levels of mutual funds"[15], a discretionary adjustment to a higher risk level, without narrative explanation for the adjustment, gives no information to investors and advisors about the material qualitative risks.

4.10. FAIR Canada finds it completely puzzling that the CSA's response to the recommendation of adopting the best practice of the ESMA and the KIID is: "It should be noted that the European summary document and risk scale have significant differences compared to our summary

14 CSA Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Delivery of Fund Facts, (2013) 36 OSCB 6001 at page 6003.

15 CSA Notice and Request for Comment – CSA Mutual Fund Risk Classification Methodology for use in Fund Facts and ETF Facts , (December 10, 2015), 38 OSCB 10307 at 10319, available online at: https://www.osc.gov.on.ca/documents/en/Securities-Category8/ni_20151210_81-102_mutual-fund-risk-classification-methodology.pdf

documents. In our view, the Proposed Methodology best reflects the reality of our mutual fund market which allows for comparability across mutual funds."[16]

4.11. Europe has developed a regulatory regime that allows for key information documents to be provided not only for mutual funds and exchange traded funds, but also for other investment products including packaged investment products and insurance-based products such as structured products, and index-linked notes.[17]

4.12. The reality of the Canadian mutual fund market is that summary documents presently contain weak risk disclosures with no comparability since the fund manager is free to use whatever methodology they like. We refer you to letters to securities regulators mentioned in our previous submission.[18] It has been demonstrated that the IFIC methodology can be unreliable and inconsistent between funds that are otherwise very similar.[19] The CSA has undertaken significant analytical work and research (we commend the CSA for doing so) and could very easily reform its Proposed Methodology and the risk section to make it live up to international standards. We strongly urge the CSA to do so.

5. Risk of Loss of Capital Critically Important to Investors

5.1. Investors understand risk as the chance of losing money and want to know how much they stand to lose.[20] The strongest criterion for an investor deciding not to buy a particular investment "is simply the chances of losing money".[21] This is reflected in IOSCO's definition of investment risk at paragraph 3.2 above.

5.2. Accordingly, we agree with the OSC's Investor Advisory Panel and Kenmar Associates that clear unambiguous disclosure of potential for loss is extremely important. Given the results of investor testing done in 2012, this should be found in the "How risky is it?" section rather than in the performance section.[22]

5.3. The time needed to recover from a loss, especially a large loss, is not covered in the Proposed

[16] CSA Notice and Request for Comment – CSA Mutual Fund Risk Classification Methodology for use in Fund Facts and ETF Facts at 10317.

[17] European Commission – Packaged retail and insurance-based investment products, available online at http://ec.europa.eu/finance/finservices-retail/investment_products/index_en.htm

[18] See footnotes 6, 7 and 8 of our letter dated March 12, 2014, available online at http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-CSA-risk-classification-methodology-proposal.pdf.

[19] See our letter dated March 12, 2014, supra note 18, at footnote 9.

[20] The criteria that drive mutual fund decisions are "How much the fund earned in the past", followed by "Performance compared to similar investments" and then "Chances of losing money"; and the strongest criterion for deciding not to buy is "Chances of losing money". See Investor Education Fund, Investor behavior and beliefs: Advisor relationships and investor decision-making study, written by The Brondesbury Group, Toronto, ON, 2012 at page 23.

[21] The criteria that drives mutual fund decisions is How much the fund earned in the past, followed by Performance compared to similar investments and then Chances of losing money and the strongest criterion for deciding not to buy is Chances of losing money. See Investor Education Fund, Investor behavior and beliefs: Advisor relationships and investor decision-making study, written by The Brondesbury Group, 2012 at page 23; available online at http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

[22] The investor testing of the Fund Facts in 2012 found that retail investors see the bar graph in performance section as showing performance only and not risk.

Methodology and needs to be conveyed to investors – otherwise there is a serious risk that investors may construe a one year gain of 30 percent as making up for a previous year's loss of 30 percent.

6. FAIR Canada Opposes the Five Category Scale

6.1. The CSA has made several changes to the Proposed Methodology based on industry comments (most notably, changing to a five category scale rather than six, changing the standard deviation ranges to be consistent with the IFIC methodology, removing the list of criteria for an index to be considered acceptable as a reference index while keeping the list of reference index principles, and changing the frequency of determining the investment risk level from monthly to upon filing the Fund Facts and at least annually thereafter).

6.2. We recommend that the six category-scale be retained and that it be conveyed numerically from 1 (lowest risk) to 6 (highest risk) so as to more appropriately categorize funds and allow for more differentiation in the indicator. This will also prevent investors and advisors from conflating the investor's risk tolerance with the risk rating of an investment product. The fact that keeping the same number of categories is more convenient to the industry and avoids imposing some costs should not be a deciding factor. We see our recommendation to change it to a numerical scale from one to six as also being advantageous in decreasing the risk of mis-selling as there will no longer be the possibility of equating the risk category with an investor's risk tolerance. A person, for example, who has a "medium" risk tolerance, should not necessarily purchase a mutual fund with a "medium" volatility risk. This over-simplifies the know-your-client process and is an issue that needs to be addressed. It also does not accord with modern portfolio theory where an investor's objectives and risk tolerance should be reflected in the overall mix of products in their portfolio, not in each particular investment contained within the portfolio.

7. Frequency for Reviewing Risk Level of a Fund

7.1. If a minimum annual frequency will be required for reviewing each fund's investment risk level, the CSA should provide clear criteria for when it is appropriate (and necessary) to do this more frequently.

8. Investments other than Mutual Funds and Exchange Traded Funds

8.1. FAIR Canada is strongly of the view that summary documents of key information necessary to make an informed investment decision are needed for other products in addition to mutual funds and ETFs. We urge securities regulators to produce such documents for structured products such as principal at risk notes, alternative investment funds, and closed end funds. We urge other regulators – for banking products and insurance products – to also do so.

8.2. We also strongly are of the view that Fund Facts summary documents need be provided to retail investors before the decision to invest is made.

8.3. FAIR Canada believes that the Proposed Methodology for mutual funds and ETFs should be designed with all investment products in mind so that when all products have summary documents, it will be possible for investors to use them to compare different types of products, to the extent possible. Obviously a "one size fits all" approach will not suffice and some flexibility will be required, but one thing is clear – volatility risk alone will not suffice.

We urge the CSA to consider our comments. If disclosure of important information is incomplete or inaccurate this may lead to investors being harmed - the investor or their advisor may rely on it to their detriment and there will be a mis-match between the risk appropriate to the investor and the risk of the product. Such harm will decrease investor confidence in the financial services industry.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408/neil.gross@faircanada.ca or Marian Passmore at 416-214-3441/ marian.passmore@faircanada.ca.

Sincerely,

Canadian Foundation for Advancement of Investor Rights

CC: British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
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March 9, 2016

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VIA EMAIL

Dear Sirs/Mesdames:

Re: CSA Request for Comment
Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts
Proposed Amendments to NI 81-102 *Investment Funds* and Related Consequential Amendments

On behalf of Advocis, The Financial Advisors Association of Canada, we are pleased to respond to the Canadian Securities Administrators' ("CSA") consultation regarding the proposed amendments to National Instrument 81-102 *Investment Funds* and related consequential amendments that would effect a standardized investment fund risk classification methodology for use in Fund Facts and ETF Facts (the "Proposed Methodology").

About Advocis

Advocis is the largest and oldest professional membership association of financial advisors and planners in Canada. Through its predecessor associations, Advocis proudly continues over a century of uninterrupted history serving Canadian financial advisors and their clients. Our 11,000 members, organized in 40 chapters across the country, are licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across Canada. Advocis members provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, long-term care and critical illness insurance to millions of Canadian households and businesses.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members adhere to a professional Code of Conduct, uphold standards of best practice, participate in ongoing continuing education programs, maintain professional liability insurance, and put their clients' interests first. Across Canada, no organization's members spend more time working one-on-one on financial matters with individual Canadians than do ours. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future.

Introductory Comments

Advocis continues to support the principles behind the CSA's development of a standardized risk classification methodology for investment funds. As we stated in our response to CSA Notice 81-324 and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the "2013 Proposal"), we believe that Fund Facts, as a summary document, can be a helpful tool for consumers to use in making cursory comparisons of different investment funds.

To that end, we support initiatives that make the information in Fund Facts more relevant and reliable, which includes a standardized presentation of risk. In our view, the revised risk classification methodology released on December 10, 2015 (the "2015 Proposal") is a marked improvement over the 2013 Proposal – particularly through the retention of the current five-category structure and the adoption of the Investment Fund Institute of Canada's ("IFIC") standard deviation bands, which will avoid the needless reclassification of thousands of funds that could render millions of client accounts offside when no actual changes have occurred to the funds themselves. We laud the CSA for taking stakeholder feedback seriously to refine the Proposed Methodology while still accomplishing the objectives behind the project.

Despite this improvement, we would argue (and we believe the CSA would agree) that consumers should not be overly reliant on any one source of information before making an investment decision. We have long stated that the best role for a summary document such as Fund Facts is as a springboard to a deeper conversation between a client and his or her advisor about the opportunities and risks that a particular investment fund represents, and how that fund fits into the client's overall financial framework – being mindful of the client's particular financial position and objectives. It is through a holistic analysis, rather than the purchase of any one product, that sets consumers on the path to achieving their financial goals.

COMMENTS ON THE 2015 PROPOSAL

The use of volatility as the metric of risk

As we stated in our comments to the 2013 Proposal, it is impossible to capture all of the major risks that consumers should understand about an investment fund on Fund Facts; any attempt to capture everything on two double-sided pages would not do the exercise justice. If Fund Facts is to present one single measure of risk, we agree that – for most investment funds – it should be volatility based on the standard deviation of monthly returns due to the fact that the meaning of this metric is relatively understood by the public and its calculation is readily verifiable by third parties. (However, we do not agree with the use of standard deviation for bond funds, as we will discuss in the next section.)

Nonetheless, the CSA must be mindful that for many investors, the most prominent risk of concern is the potential of losing their capital, not the volatility of the fund's value. Therefore, we recommend that in presenting its chosen risk metric, the CSA mandate the inclusion of plain language on Fund Facts that explains the risk rating is not indicative of the risk of capital loss, but is instead a measure of the historic volatility of the value of the fund.

Further, there are many risks that are not necessarily captured by a fund's historic volatility, including currency risk, liquidity risk, concentration risk and counterparty risk. And certain funds feature unique structures that require special explanation, such as target date funds or certain income funds that use strategies such as shifting asset allocation through the expected lifecycle or the return of capital to generate a steady income stream, making the standard deviation data of such funds potentially misleading to consumers.

In the face of these considerations, we are pleased that the 2015 Proposal grants fund managers the discretion to label their fund as riskier than the Proposed Methodology would compute based on standard deviation. But for consumers to truly understand the risks and benefits of a fund before making an investment decision, they should first obtain professional financial advice and the CSA should accommodate an expansive role for such advice.

Obtaining advice provides consumers with a much better opportunity to go beyond volatility and understand all key risks, both quantitative and qualitative, of a particular investment fund, and insight as to how that particular fund fits into the consumer's larger financial plan. A professional financial advisor is able to explain complex financial concepts in a meaningful and interactive way so that clients can make a truly informed decision. To that end, we urge the CSA to mandate the inclusion of text on Fund Facts, as part of the discussion of volatility risk, recommending that consumers seek professional financial advice before making an investing decision.

Including such language may be the best solution between the CSA's research, which found that 83% of participants in the CSA's Fund Facts document testing focus group wanted a greater explanation of other specific risks,[1] and the CSA's desire to keep the presentation of risk on Fund Facts straightforward and on a common basis so as to avoid causing confusion by glossing over those risks. Concern about not being able to give these other risks their proper due in the constrained available space actually resulted in the CSA removing the list of other specific risks from Fund Facts in 2013.[2]

Historical standard deviation is inappropriate for bond funds

For bond funds, we believe the use of historic standard deviation to measure risk is inappropriate because the greatest factors affecting their volatility are forward-looking, being the time to maturity of the underlying bonds and the stability of interest rates. The price of long-term bonds tends to be much more volatile than the price of short-term bonds, and a bond's interest rate risk decreases ever year that the bond moves closer to maturity.

Rather than standard deviation, we recommend the CSA use duration to measure a bond fund's risk. Duration, a measure of a bond's price sensitivity to changes in interest rates, is the single most important determinant of bond price movements and is relatively easy for consumers to understand: if a bond fund has a duration of 5, it means that the bond fund will lose 5% of its value if interest rates rise a mere 1%. This is a very significant factor to consider for long-dated real return bond funds.

For example, the very popular iShares Canadian Real Return Bond Index ETF, with over $430 million in assets, has a duration that is over 15 years.[3] So in its case, a mere 0.5% rise in interest rates across the yield curve would cause the bond fund to lose almost 8% of its value. Many consumers would not expect a bond fund that is almost entirely comprised of quality government bonds to be that susceptible to such a small interest rate move.

Therefore, we believe that duration is the superior metric to use to categorize the risk of bond funds. Should the CSA wish, we would be pleased to assist it in establishing the numerical bands that correspond to the five risk categories on Fund Facts.

Guidance regarding individual fund risk classification and overall account and portfolio suitability

We reiterate our statement made in our comments to the 2013 Proposal: contemporaneous with it mandating use of the Proposed Methodology, the CSA should issue accompanying guidance that makes it clear that the risk classifications computed by the Proposed Methodology are not, by themselves, determinative of suitability, but one of many factors to consider as part of an advisor's Know Your Product and Know Your Client suitability assessment obligations.

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[1] CSA Point of Sale Disclosure Project: Fund Facts Document Testing, Allen Research Corporation (September 2012), http://www.osc.gov.on.ca/documents/en/InvestmentFunds/pos_201209_fund-facts-doc-testing.pdf at page 18.
[2] CSA Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Delivery of Fund Facts, (2013) 36 OSCB 6001 at page 6009.
[3] See http://www.blackrock.com/ca/individual/en/literature/fact-sheet/xrb-ishares-canadian-real-return-bond-index-etf-fund-fact-sheet-en-ca.pdf.

That is, if based on a client's New Account Application Form or Know Your Client information, the client demonstrates a "medium to high" risk tolerance, this should not mean that any investment fund which falls in the Proposed Methodology's 16-20% band is *de facto* suitable; conversely, any investment fund that falls outside that band should not be *de facto* unsuitable. Since volatility risk does not capture all of the relevant material risks, it would be improper for industry or consumers to conflate the Proposed Methodology's risk computation with a proper suitability assessment.

Further, many professional advisors utilize modern portfolio theory ("MPT"), including a variety of specialized software applications that assist in creating MPT-optimized portfolios, to better serve their clients. In doing so, any particular investment fund is likely to be grouped with several other funds in the client's account. So whether the account's overall risk exposure is compliant with the client's risk tolerance must be viewed holistically, in the context of all the funds in the client's account and the consumer's financial plan, including the client's investment objectives, tax considerations and time horizon. For a particular client account with a "medium risk" tolerance, a mix of higher volatility and lower volatility investments may be better suited, rather than simply filtering for those funds that the Proposed Methodology deems as representing medium risk.

One major risk that consumers tend to overlook is diversification risk. For example, a consumer with a low risk tolerance may, based solely on their traditional risk rating in Fund Facts, select a variety of bond funds. This type of behaviour leaves the consumer particularly vulnerable to capital declines in a rising interest rate environment, and a consumer who does not understand the link between yield and price could feel that the low risk rating was misleading, harming their confidence in financial markets, fund manufacturers and securities regulators. Here, a better understanding of risk correlation and diversification would have resulted in superior outcomes for the consumer.

Therefore, we recommend that upon implementation of the Proposed Methodology, the CSA provide accompanying guidance which makes clear that despite the regulated risk presentation brought about by the Proposed Methodology, a fund's risk classification cannot be used to directly determine whether the consumer's account is in compliance with the risk tolerance stated in his or her KYC and KYP suitability profile; overall compliance must be judged more holistically, in concert with the other investments in the account and in the context of the client's personal situation.

Wraps, Funds-of-Funds and Portfolio Series Investment Solutions

We believe that special attention must be paid to wraps, also known as funds-of-funds and portfolio solutions (amongst other names), which have become very popular "all in one" choices for many retail investors. A typical wrap is made up of several (often eight to 12) underlying mutual funds, each of which would normally have its own Fund Facts and risk classification presented thereon. Fund manufacturers use MPT to assemble a mixture of more aggressive funds (such as emerging market equity funds), pooled with more conservative funds (such as domestic bond funds), and it is the combination that strikes the risk-reward balance that makes these products so popular.

Currently, on a wrap's Fund Facts, industry practice has been to present only a single "top line" risk classification that is supposed to represent the wrap's overall risk – there is no disclosure of the risk of the wrap's individual components. Doing so usually means that the wrap is bluntly labelled as being medium risk. As there are many ways to get to “medium”, we believe this approach strips valuable context from the wrap’s risk classification.

A more insightful approach would be for the wrap’s Fund Facts (and its prospectus) to summarize the risk profile of the underlying funds as a weighted percentage composition. For example, instead of simply labelling a wrap as “medium” risk, a fund company could describe the wrap’s risk as: "10% high, 15% medium-high, 60% medium and 15% low", based on the weighting and risk classification of the wrap’s component funds. This would better allow a client and financial advisor to understand how the investment solution fits with the client's profile.

Transition Issues

According to the 2015 Proposal, the CSA expects to publish final rules in the fall of 2016 (the “Publication Date”) and have the Proposed Methodology come into force three months after the Publication Date (the “In Force Date”). After the In Force Date, the risk level of conventional mutual funds and exchange-traded funds will be determined in accordance with the Proposed Methodology for each subsequent filing of Fund Facts or ETF Facts and at least annually.

In our opinion, this transition schedule is too aggressive. While the 2015 Proposal contains many improvements over the 2013 Proposal that should smooth the implementation of the Proposed Methodology, there will inevitably be unforeseen issues that will take additional time to address. Because of the large number of funds to process, fund managers will require at least one year to upgrade and test their systems and generate the new risk ratings.

Dealers and advisors will have a more onerous task, as funds not currently employing the IFIC methodology could see a change in their risk rating, impacting client accounts. SRO requirements require that such events be reviewed through client meetings to explain changes and ensure ongoing suitability. Dealers would have to update their policies regarding suitability and their account supervision systems. Therefore, we believe that dealers and advisors would require a separate transition period of approximately two years.

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We look forward to working with the CSA as it works to implement the Proposed Methodology. Should you have any questions, please do not hesitate to contact the undersigned, or Ed Skwarek, Vice President, Regulatory and Public Affairs at 416-342-9837 or eskwarek@advocis.ca.

Sincerely,

Greg Pollock, M.Ed., LL.M., C.Dir., CFP
President and CEO

Caron Czorny, FLMI, ACS, CFP, CLU, CH.F.C., EPC, CHS, ICD.D
Chair, National Board of Directors

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March 9, 2016

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Attention:

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Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs and Mesdames:

CSA Notice and Request for Comment – CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts. Proposed Amendments to National Instrument 81-102 *Investment* Funds AND Related Consequential Amendments.

We are writing to provide you with comments on behalf of the Members of IFIC with respect to the CSA Notice and Request for Comment published on December 10, 2015 regarding the CSA Mutual Fund Risk Classification Methodology (the "CSA Methodology").

We note that the revised methodology responds to a number of concerns and suggestions raised by IFIC and industry participants in relation to the 2013 Proposed CSA Mutual Fund Risk Classification Methodology, and that it now largely reflects the methodology currently in use by the majority of the industry as articulated in the IFIC Voluntary Guidelines for Fund Managers Regarding Fund Volatility Risk Classification (the "IFIC Methodology")

General Comments

Standardized Methodology

We fully support the CSA's intention to mandate a standardized fund risk classification methodology. A voluntary approach has served market participants well over the past decade; however, it has not been adopted by all Canadian fund managers, resulting in inconsistencies and causing potential confusion for investors.

Risk Indicator

We agree with the CSA's choice of standard deviation as the most suitable risk indicator. Historical volatility risk as measured by the standard deviation of fund performance is the most comprehensive, easily understood form of risk.

Calculation of Standard Deviation

It should be noted that there are some differences in the calculation of standard deviation in the CSA Methodology as compared to the IFIC Methodology; however, we do not expect a material impact on risk classification if fund managers use the standard deviation calculation as outlined in the CSA Methodology, as opposed to the three and/or five-year standard deviations in the IFIC Methodology.

The standard deviation calculation in Step 2 of the IFIC Methodology is consistent with the calculation as laid out in the CSA Methodology. In the IFIC Methodology, the results are compared to an appropriate benchmark index (a broad range of market indices and comparative benchmarks was selected to represent the different asset categories available to investors). If the fund's standard deviation for each period does not differ materially from the appropriate index, the fund is categorized to the appropriate volatility classification. **However**, if the fund's standard deviation for each period differs materially from the appropriate index, the average (since inception) of the rolling three and/or five-year standard deviations for the fund are determined (Step 3 of the IFIC Methodology). This is compared to the standard deviation bands as presented in Appendix 1 of the IFIC Methodology in order to determine the appropriate volatility classification.

Formation of an Advisory Committee on Fund Risk

It is important that the methodology for assessing fund risk be kept current through regular reviews and updates that reflect product changes, market factors and a host of other considerations. The IFIC Methodology is a result of careful thought and analysis by a number of highly qualified and experienced experts on IFIC's Fund Risk Classification Task Force who developed the original methodology and who review it annually to ensure it remains meaningful and relevant.

We strongly recommend that the CSA establish a similar committee to ensure that that CSA Methodology remains relevant with market trends and volatility. It is essential that this committee include broad industry participation, along with representatives from the regulators, data providers, and academics. We recommend that the CSA Methodology be reviewed by this committee on at least an annual basis.

Members from IFIC's Fund Risk Classification Task Force should be considered by the CSA as members of any advisory committee that is established due to their extensive experience and expertise in this area.

Comments on Key Changes to the 2013 Proposal

Application of Proposed Methodology to ETFs

We agree that the CSA Methodology be used both for exchange-traded funds and conventional mutual funds.

Investment Risk Level and standard deviation ranges

We support the CSA retaining the five-category risk scale currently used in the Fund Facts. The fact that the proposed risk band break points are consistent with those used in the IFIC Methodology will ensure a smooth transition to the CSA Methodology.

Use of a Reference Index (Mutual funds with less than 10 years of history)

We agree with the principle of using a reference index, or a composite of several market indices, as a proxy for determining the risk rating of a fund or ETF that does not have a sufficient 10-year performance history, however, the CSA Methodology as currently proposed does not provide sufficient guidance and/or flexibililty to fund managers, particularly with regard to innovative strategies. It would be helpful if the CSA could provide a concrete example of a new fund (that follows an unconventional or innovative strategy) and the process that would be taken to select an appropriate reference index for that fund.

We note that the requirements that the index be “highly correlated” to the returns of the fund or ETF and contain a high proportion of the same securities would likely not be appropriate or achievable for many fund managers, in particular those pursuing innovative approaches such as low beta strategies. In their 2011 paper “Benchmarking Low-Volatility Strategies”, Blitz and van Vliet discuss benchmarking a low-volatility strategy against the capitalization-weighted market index and note that “...a straight comparison of returns is not appropriate, given that low-volatility strategies tend to exhibit significantly lower risk (volatility, beta).”

The CSA Methodology does not provide sufficient details on the steps that should be taken if the chosen reference index does not meet all 10 principles (a to j) outlined in the Request for Comments. It would be useful if the CSA could provide guidance regarding how to choose a proxy index in this case.

As mentioned in our response to CSA Notice 81-324, we would caution the CSA that determining an appropriate reference index may be difficult for funds or ETFs which intend to behave differently than any existing reference index. In those situations where there is little or no fund history, and where there is no reference index with a 10-year history that is appropriate for the fund, it is not clear how the CSA would recommend the CSA Methodology be applied. Ultimately, each fund manager must ensure that the risk rating, which forms part of its disclosure record, is not misleading. The absence of discretion to select an appropriate reference index creates the risk that a fund manager may not select the applicable risk rating. Accordingly, we recommend permitting the fund manager discretion, in limited circumstances, to select a reference index (or composite of reference indices) which may not, in all cases, be "highly correlated" to the returns of the fund or ETF or have a high proportion of the same securities of such fund or ETF. In such instances, the use of discretion must be disclosed in the description of the reference index to be included in the MRFP. Finally, we ask that the CSA revisit the guiding principles for selecting a reference index and provide updates to the guiding principles on a routine basis after the methodology is finalized.

Members of IFIC’s Fund Risk Classification Task Force would be pleased to engage with the CSA further on the topic of selecting an appropriate reference index.

Frequency of determining the investment risk level of a mutual fund

We agree with the frequency of determining the investment risk level of a mutual fund (i.e. the investment risk level must be determined upon the filing of a Fund Facts or ETF Facts and, in any case, at least annually).

Record of standard deviation calculation

We agree with the requirement to maintain records of standard deviation calculations for a period of 7 years.

Other Comments

Adjustments to Disclosure Documents including Fund Facts

We note that once the CSA Methodology is mandated, changes will need to be made to disclosure documents, including the Fund Facts. The ‘How risky is it?’ section of the Fund Facts currently states: “*When you invest in a fund, the value of your investment can go down as well as up. XYZ Mutual Funds has rated this fund’s risk as medium.*” With the CSA Methodology, and specifically the ‘Use of a Reference Index’ section, fund managers are now following a prescribed methodology. As a result, we feel that the language in the disclosure documents should be amended to reflect this.

***

Thank you for providing us with an opportunity to comment on this important issue. We appreciate the careful thought and consideration the CSA has given throughout this consultation process. Should you have any questions or desire to discuss these comments, please contact me directly by phone at 416-309-2325 or by email at ibragg@ific.ca.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Ian Bragg
Director, Research and Statistics

cetfa
Canadian ETF Association

March 9, 2016

The Secretary Ontario Securities Commission 20 Queen Street West 22nd Floor Toronto, Ontario M5H 3S8 Fax: 416-593-2318 comments@osc.gov.on.ca	Me Anne-Marie Beaudoin Corporate Secretary Autorité des marchés financiers 800, rue du Square-Victoria, 22e étage C.P. 246, tour de la Bourse Montréal (Québec) H4Z 1G3 Fax : 514-864-6381 consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Re: CSA Notice and Request for Comment – CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts and Proposed Amendments to National Instrument 81-102 Investment Funds and Related Consequential Amendments ("Proposed Amendments")

Dear Sirs and Mesdames:

This letter is submitted on behalf of the Canadian Exchange-Traded Fund Association ("**CETFA**"). Based in Toronto, CETFA is the sole exchange-traded fund ("**ETF**") association in Canada and represents numerous Canadian ETF providers.

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Canadian ETF Association

CETFA is the national voice of Canada's ETF industry, representing more than 95% of the country's ETF assets under management. Canadian investors have over $87 billion invested in more than 380 Canadian-listed ETFs. As ETF usage continues to grow in Canada, CETFA seeks to educate Canadians on the appropriate use of exchange traded funds, as well as work proactively with members and regulators to ensure the ETF industry adopts best practices and standards.

CETFA appreciates the opportunity to provide comments on the Proposed Amendments mandating a CSA risk classification methodology for use by the fund managers for the purpose of determining the investment risk level of conventional mutual funds and exchange-traded mutual funds (ETFs).

CETFA agrees with the substance and purpose of the Proposed Amendments, and generally supports the key changes made to the earlier version of the proposed methodology that was published on December 12, 2013 in CSA Notice 81-324 and Request for Comment Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts. In particular, CETFA supports reverting the Proposed Amendments back to a five-category scale that is more consistent with the standard deviation ranges in the IFIC Methodology.

CETFA also supports standard deviation as a suitable risk indicator for the reasons outlined in the Proposed Amendments, and welcomes its application to exchange traded funds. We believe that standardized risk classification methodology will help to provide investors with meaningful comparisons between conventional mutual funds and ETFs.

With respect to whether standard deviation should be calculated with returns based on market price or net asset value, while only a minority of ETFs would produce a different risk rating by using market value versus net asset value, CETFA supports using net asset value in determining a fund's investment risk level. Using net asset value also allows for consistency with performance reporting and continuous disclosure requirements applicable to mutual funds.

Thank you for this opportunity,

Pat Dunwoody
Executive Director
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The Canadian Advocacy Council for Canadian CFA Institute Societies
ADVOCATING THE CFA INSTITUTE'S CODE OF ETHICS AND STANDARDS

March 9, 2016

BY EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

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-and-

The Secretary, Ontario Securities Commission
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Dear Sirs/Mesdames:

Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments (the "Proposed Amendments")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to respond to the Proposed Amendments.

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[1]The CAC represents more than 15,000 Canadian members of the CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 135,000 members in 151 countries and territories, including 128,000 CFA charterholders, and 145 member societies. For more information, visit www.cfainstitute.org.

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As noted in our response to CSA Notice 81-324 and Request for Comment – *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts*, the CAC is generally supportive of a standardized risk methodology. We are also supportive of mandating the same methodology for use in the proposed ETF Facts.

We understand that the CSA has reviewed alternative measurements but is continuing to propose standard deviation as the sole risk indicator because it is a widely accepted measure of volatility. We continue to question the premise that volatility is the only risk measure that should be required for the Fund Facts and ETF Facts. Standard deviation alone does not help explain whether a fund's volatility is due to exposure to the market or the manager's investment performance. A low standard deviation, and thus low realized volatility over a time period, does not necessarily mean that an investment is devoid of other substantial risks. In addition, the use of standard deviation alone as a volatility and risk measurement is not, in our view, sufficient, particularly where a fund has not been in existence long enough for that track record to have any statistical meaning or where the volatility of a benchmark is substituted and may not properly represent the volatility or other risks of the mutual fund or ETF in question.

In some respects, the use of standard deviation as a volatility measure is circular. While many disclaimers are required to the effect that past performance is not an indicator of future results, standard deviation is inherently calculated on a return stream of past performance and is thus an implicit endorsement of the use of past returns in an investor's evaluation of their risk and return goals.

We do not believe that most investors understand the meaning of standard deviation within the context of their portfolio, nor have a sufficient understanding to interpret the results. As an example of additional disclosure, in conjunction with the use of the "risk bands", it could be helpful for an investor to be provided with information such as the amount of money in dollar terms that could be lost if an investment fell within one of the bands – i.e. $1000 in a high risk band could have lost $X over the last 10 years. If the CSA were to require additional information in conjunction with the existing risk scale, particularly in graphic form, it would provide additional transparency to retail investors.

Investors usually perceive risk as the combination of the totality of risks affecting their portfolio, including risks other than volatility risk. The potential downside to a mutual fund or ETF investment may in fact be greater than that indicated by normal historical volatility. We understand that under the revised Proposed Amendments, the investment risk level of a mutual fund or ETF may be increased beyond the level in which it might be placed based on the methodology. We would encourage the CSA to provide additional guidance with respect to when such an increase might be appropriate.

While standard deviation is an informative measure, it is not a complete measure of risk as has been highlighted above, and can mask risks that arise as a result of the complexity of an investment product. As an illustrative example, a short-term fixed income mutual fund or ETF could have very low historical volatility over the measurement period in question, but be quite risky as a result of the complexity of the fund's underlying investments, some of which could have very asymmetric risk profiles in the event of a credit event, liquidity issues, or an interest rate shock. The risk rating of the fund, based on standard deviation, would have given the investor no insight into the asymmetric risk profile and complexity of the fund's investments. The Journal of Finance has recently published a paper [A Risk and Complexity Rating Framework for Investment Products] (Koh et al.) discussing a complexity rating framework, which would help inform and augment traditional risk ratings. The paper describes other vectors that could be considered for risk measurement and required mutual fund and ETF disclosures by the CSA in future projects. The CAC would be happy to engage with interested CSA working group members on this point for a more detailed dialogue in future.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have or to meet with you to discuss these and related issues in greater detail. We appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) "*Michael Thom*"

Michael Thom, CFA
Chair, Canadian Advocacy Council

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March 9, 2016

British Columbia Securities Commission
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Sent via Email to comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments

I am pleased to again have the opportunity to share my input on this important issue. For background, HighView Financial Group is the brand under which we operate our business.

HighView Asset Management Ltd. ("HighView") is registered in Ontario, Alberta, British Columbia and Saskatchewan in the category of Portfolio Manager. HighView design portfolios for affluent families and institutions.

HighView is in a fiduciary relationship with each client. Central to our fiduciary duty is the notion of transparency – both in the illustration of risk before clients formally engage us and via ongoing reporting after they become clients. This is important to us. In our view, risk is a highly personalized concept. Accordingly, we dedicate significant thought and resources to make sure that risk is measured in ways that are meaningful to clients and communicated/illustrated in ways that they grasp to empower them to make fully-informed investment decisions.

Standardized method to measure and illustrate risk

As noted in my submission two years ago on this issue, we strongly support a standardized risk measurement. This facilitates the comparison across different products and eliminates inconsistencies in the status quo. Since 10-year standard deviations (SD) are more stable than 3- and 5- year SD measures, the requirement for 10-year SD measures is a significant improvement.

Standard Deviation and the CSA's proposed risk communication

The CSA note that SD's "*calculation is well known and established*[1]" – a claim that the industry repeatedly trumpeted in its submissions to the 2013 consultation supporting the status quo. I agree with this claim if we're talking about the investment industry and academia. But this measure is supposed to inform the investing public. And neither the CSA nor the investment funds industry has demonstrated that retail investors understand standard deviation (the calculation or the output). More importantly, the CSA has not tested whether investors can take the five-point descriptive risk scale and equate it with their own views of risk.

Assuming for a moment that SD is indeed well-known and established among retail investors, I note that neither the status quo nor the CSA's proposed method actually discloses SD to investors. It simply takes the SD measure and interprets it for people using the five-point

[1] Page 3 of the CSA's Notice and Request for Comment dated December 10, 2015: https://www.osc.gov.on.ca/documents/en/Securities-Category8/ni_20151210_81-102_mutual-fund-risk-classification-methodology.pdf

descriptive scale. And the CSA has not tested if the very investors they aim to protect and inform can meaningfully interpret the five-point scale.

In my view, the CSA's proposed risk illustration and communication to be used in Fund Facts and ETF Facts will not communicate the intended information to end investors. The CSA proposes calculating a fund's trailing 10-year annualized standard deviation, applying the number to a qualitative five-point scale and illustrating the scale on Fund Facts and ETF Facts documents. An example of the chart and accompanying text is shown below.

Low	Low to medium	**Medium**	Medium to high	High

This rating considers how much the Fund's returns have changed from year to year. It doesn't tell you how volatile the Fund will be in the future. The rating can change over time. A fund with a low risk rating can still lose money. For more information about the risk rating and specific risks that can affect the Fund's returns, see the Risk section of the Fund's simplified prospectus.

Consider the case of a Canadian Equity Index ETF. Its trailing 10-year standard deviation at February 29, 2016 was 13.56% annually[2]. This would result in a risk illustration identical to the above sample – i.e. medium risk – under the status quo and the CSA's proposed method.

If in fact that the CSA is convinced that SD's calculation and output are well known, then a numerical scale – with the actual number disclosed – is preferable since it allows each individual investor to make the interpretation. This could look something like the sample illustration below. At a minimum, show the SD number on the existing descriptive scale.

			This fund ---->		13.6% per year				
1	2	3	4	5	6	7	8	9	10

[2] Computed using monthly total returns based on closing market prices. Raw monthly standard deviation – i.e. computed on monthly returns and not annualized – was 3.91%.

Standard deviation as a risk measure

Standard deviation is a meaningful statistic if used properly. I have long held it out as a measure of behavioural risk[3]. And our firm uses it in two ways – as a statistic alongside downside risk metrics; and as an input in risk-adjusted return metrics. But we never use it as the primary statistic to communicate risk. It's a supplemental statistic.

Continuing with the aforementioned example of a Canadian Equity Index ETF, its standard deviation is not terribly meaningful even to those who understand it without also providing the arithmetic average return over the measurement period. Investors can only translate a SD measure into a range of possibilities if they are also provided with the arithmetic average. The table below illustrates this idea.

	Monthly	Annual
Standard Deviation	3.91%	16.68%
Arithmetic Average	0.38%	7.04%
Average – 3SD	-11.35%	-43.00%
Average + 3SD	12.11%	57.08%

The Canadian Equity Index ETF had an average monthly return of 0.38% with a standard deviation of 3.91%[4]. Both are monthly figures – i.e. not annualized. Taking the average and triple the SD, a range of expectations can be formed. In this example, monthly returns might be expected to range from -11.35% to a high of 12.11%. The "Annual" column above illustrates the same math using annualized returns.

Investors have wildly diverse levels of investment knowledge and experiences. Accordingly, this approach is challenged by having to explain these statistical terms in practical and comprehensible language. For this reason, I believe that using intuitive risk metrics is an improved approach.

[3] See http://www.highviewfin.com/blog/volatility-measures-behavioural-risk/
[4] Measured using the 120 monthly total returns through February 2016

Intuitive risk metrics

No single statistic can fully capture investment risk. But if I were to choose a single metric to measure and illustrate risk for retail investors it would be *Maximum Drawdown* and *Recovery Time*. Continuing with our Canadian Equity Index ETF example, we've seen that its risk would be rated as "medium" under the existing and proposed methods.

Using the same series of monthly returns that are needed to calculate SD (required under the current and proposed methods), one can calculate *Maximum Drawdown* (shown below as Biggest Drop) and *Recovery Time*[5]. The table below illustrates these figures for our Canadian Equity Index ETF example. And ideally this sort of illustration should be paired with a frequency – i.e. this kind of drop has happened every eight years in the past – for complete context.

Biggest Drop	-48.0%
Peak to Trough (months)	25
Trough Thru Recovery (months)	39

Another key ingredient to making this kind of risk measure work is the mandatory inclusion of at least one bear market – regardless of how long ago it occurred. While Fund Facts' use of rolling returns partially addresses the illustration of downside risk, even the CSA's requirement to use ten years of historical data will often fail to capture any bear markets. The above statistics can be calculated using the same monthly data already used for both the status quo and the CSA's proposed method. Given that every fund company I know uses a professional portfolio management system, these statistics should not be burdensome to calculate and maintain.

This kind of measure will be more stable than the status quo and the CSA's proposed method. As prices rise and SD measures fall, Biggest Drop or Maximum Drawdown are highly stable – only changing when a more severe bear market materializes. When risk is shown numerically and focus on losses, risk ratings don't fall – as has occurred on dozens of funds over the past year.

[5] Note also that while we split *Recovery Time* into two time frames – i.e. how long to hit bottom and how long to fully recover – this can be combined into a single line item showing the total time spent in loss territory.

Fund risk rating changes

I have been tracking fund and ETF sponsors' risk rating change announcements since last spring[6]. My sample includes 61 mutual funds and ETFs – of which 45 are unique mandates[7] – for which risk ratings were changed. See **Appendix A** for the full list of risk rating changes covered.

Thirty-five of the 45 unique mandates – or 78% – saw risk ratings fall in the face of rising asset prices. Yet valuation risk increases as asset prices rise. The CSA's requirement to base ratings on 10 years of history will help reduce this effect, but it will remain a problem.

In two short years, the worst bear market of this generation will disappear from the trailing ten-year record. And if another bear market has not occurred in that time, the 2007-08 Financial Crisis will slip out of the 10-year time frame and standard deviations are likely to fall. That's exactly what happened with 78% of the fund risk rating changes I studied. But consider the following statistics from my sample of 45 risk rating changes.

- 24 of the 45 unique mandates have been around long enough to have experienced at least one bear market in the past.
- Nineteen of these 24 funds are now rated as "medium" risk or lower.

	Low Risk Funds	Low-Medium Risk Funds	Medium Risk Funds
# of Funds	10	5	4
Average Bear Market Loss	-21%	-36%	-31%
Average Time Spent under water	3 years	5 years	2 years

[6] While I've attempted to capture all risk rating changes I cannot be sure that I've succeeded in this regard. Sources include news stories in the public domain and fund company press releases.
[7] For example, a fund offered as both a trust and a corporation are treated as two funds but one unique mandate.

While I hope that the CSA's proposed method will decrease the kind of *risk category jumping* I've observed over the past several months, the magnitude of decrease is unclear at this point. Moreover, neither standard deviation nor the CSA's proposed risk scale are capable of communicating the simple concept of loss and recovery to retail investors.

I applaud the CSA for proposing a stronger and uniform standard for fund and ETF risk ratings. But I also strongly urge the CSA to consider a more intuitive risk measure prior to making its final decision.

I welcome the opportunity to further discuss this issue and my specific comments with the CSA.

Sincerely,

Dan Hallett, CFA, CFP
Vice-President & Principal
HighView Asset Management Ltd.

Appendix A – Sample of risk rating changes from May 2015 to February 2016

↓	35	Risk reduction	78% of risk rating changes have been			
↑	10	Risk increase	risk reductions			
Fund Name	**Direction**	**Previous Risk Rating**	**New Risk Rating**	**Risk Rating Method**	**Last Bear Market Drop**	**Time Under Water**
Franklin Bissett Canadian Balanced	↓	Low-to-Medium	Low	Historical Volatility	-28%	2 years & 4 mos
Franklin Bissett Canadian All Cap Bal	↓	Low-to-Medium	Low			
Franklin Bissett Canadian High Dividend	↑	Low-to-Medium	Medium		-35%	1 year & 9 mos
Franklin Bissett Dividend Income	↓	Low-to-Medium	Low		-25%	1 year & 10 mos
Franklin Quotential Balanced Income	↓	Low-to-Medium	Low		-23%	2 years & 5 mos
Franklin Quotential Diversified Equity	↓	Medium	Low-to-Medium		-44%	5 years & 7 mos
Franklin World Growth	↓	Medium	Low-to-Medium		-46%	3 years & 11 mos
Templeton Asian Growth	↑	Medium	Medium-to-High			
Templeton BRIC	↑	Medium-to-High	High		-52%	still recovering (after 8.3yrs)
Templeton Global Bond	↓	Low-to-Medium	Low		-13%	3 years & 7 mos
Templeton Global Smaller Companies	↑	Medium	Medium-to-High		-55%	6 years & 3 mos
Sprott Enhanced Equity	↓	Medium	Low-to-Medium	Historical Volatility		
Sprott Enhanced Balanced	↓	Low-to-Medium	Low			
NEI Select Conservative Portfolio	↓	Low-to-Medium	Low	Historical Volatility	-17%	3 years & 6 mos
O'Leary Canadian Dividend	↓	Medium	Low-to-Medium	Historical Volatility		
O'Leary Canadian Balanced Income	↓	Low-to-Medium	Low			
O'Leary Conservative Income	↓	Low-to-Medium	Low			
O'Leary Global Dividend	↓	Medium	Low-to-Medium			
O'Leary Emerging Markets Income	↑	Low-to-Medium	Medium			
RBC O'Shaughnessy U.S. Growth Fund	↑	Medium-to-High	High	Historical Volatility	-66%	still recovering (after 9.2yrs)
RBC Private O'Shaughnessy U.S. Growth Equity Pool	↑	Medium-to-High	High			
MDPIM Canadian Bond Pool	↑	Low	Low-to-Medium	Historical Volatility		
MD Strategic Yield	↑	Medium	Medium-to-High			
MD Precision Moderate Growth Portfolio	↑	Medium	Medium-to-High			
Standard Life Diversified Income	↓	Low-to-Medium	Low	Historical Volatility	-17%	1 year & 6 mos
Standard Life U.S. Dividend Growth	↓	Medium	Low-to-Medium		-33%	5 years & 8 mos
Standard Life Canadian Equity Growth	↓	Medium-to-High	Medium			
Standard Life Canadian Equity Value	↓	Medium-to-High	Medium			
Manulife Diversified Strategies	↓	Low-to-Medium	Low	Historical Volatility		
Manulife Special Opportunities Cl	↓	High	Medium			
Manulife China Class	↓	High	Medium-to-High		-52%	7 years & 8 mos
Manulife Global Real Estate	↓	Medium-to-High	Medium		-42%	3 years
Marquest Monthly Pay Fund	↓	Medium	Low-to-Medium	Historical Volatility	-40%	3 years & 5 mos
Marquest Global Balanced Fund	↓	Medium	Low		-48%	6 years & 3 mos
Marquest Covered Call Canadian Banks Plus	↓	Medium	Low-to-Medium			
Marquest American Dividend Growth	↓	Medium	Low-to-Medium			
Invesco Intactive 2023 Portfolio	↓	Low-to-Medium	Low	Historical Volatility	-20%	1 year & 6 mos
Invesco Intactive Diversified Income Portfolio	↓	Low-to-Medium	Low		-18%	3 years & 8 mos
Fiera Capital Bond Class	↓	Low-to-Medium	Low	Historical Volatility	-5%	1 year
Symmetry Conservative Portfolio	↓	Low-to-Medium	Low	Historical Volatility		
Mackenzie Gold Bullion Class	↓	Medium	Medium-to-High		-50%	27 years & 2 mos
Standard Life Canadian Small Cap Fund	↓	High	Medium-to-High	Historical Volatility	-49%	2 years & 9 mos
Standard Life Global Bond Fund	↓	Medium	Low-to-Medium		-19%	5 years & 11 mos
BMO Equal Weight US Banks Index ETF	↓	High	Medium	Historical Volatility	-19%	still recovering (after 7mos)
BMO Equal Weight US Banks CAD-Hedged Index ETF	↓	High	Medium		-27%	still recovering (after 7mos)

Multiple versions of funds (i.e. trust, corporate class, series F, series T, series A, etc.) are excluded for brevity. Risk stats are calculated on longer running version. Raw data source: GlobeInvestorGold.com

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March 9, 2016

VIA E-MAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Attention:
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Me Anne-Marie Beaudoin
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Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
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consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts – Proposed Amendments to NI 81-102 *Investment Funds* and Related Consequential Amendments (the "Proposed Amendments")

We are writing in respect of the request for comments dated December 10, 2015 regarding the Proposed Amendments. We appreciate the opportunity to comment on these important matters.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide build their financial security. As of February 29, 2016, Invesco and its operating subsidiaries had assets under management of approximately US$741 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

Invesco Canada is registered as an Investment Fund Manager, an Adviser and a Dealer in Ontario and certain other provinces. Our investment products are primarily bought by and sold to retail investors. As such, we take a great interest in regulatory discussions that impact those investors.

We have previously commented on CSA Notice 81-324 and Request For Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* wherein we submitted that standard deviation is not an appropriate measure of risk for a retail investor because retail investors are less concerned with periodic fluctuations in the value of their investments than they are with the risk of loss of capital. (We also noted the inherent dangers of oversimplifying a complex concept into misleading nomenclature.) In that submission, we concluded that best/worst period performance and recovery times are better measures of risk for a retail investor since that gives an indication of not only the maximum impairment of capital that a particular mutual fund has had historically but also an indication of how long it might take to recover from such an impairment of capital. Importantly, virtually every investor who submitted comments, virtually every "investor advocate" (including the Ontario Securities Commission Investor Advisory Panel, the Small Investor Protection Association of Canada, Kenmar Associates and, to a significantly lesser degree, the Foundation for the Advancement of Investor Rights), and even some of our industry colleagues expressed views similar to both our submissions and the conclusions that we drew. As such, we are surprised that the Canadian Securities Administrators (the "CSA") wholesale rejected these submissions in a rule proposal designed to protect retail investors. We urge the CSA to reconsider this approach.

Assuming that the CSA will not reconsider its approach, we will limit our comments to one specific concern we have with the Proposed Amendments, namely the criteria for using a reference index where a mutual fund has less than 10 years of performance history (being the vast majority of mutual funds offered in Canada) which are included in the instruction to Item 4 (the "Instruction") of proposed Appendix F to National Instrument 81-102 *Investment Funds* ("NI 81-102"). It is not clear whether a proposed reference index must meet all 10 criteria listed in the Instruction or if an investment fund manager needs merely to consider those criteria in selecting a reference index. (In the latter case, the CSA implicitly acknowledges that in some cases, many criteria cannot be met, although if that is the case, we believe an explicit statement to that effect would not only be helpful but necessary.) In some cases, it is not at all clear what some of the criteria even mean and, therefore, we would urge the CSA to clarify this in a future publication. Our letter is organized as follows: first, we will discuss the specific reference fund criteria that raise the greatest concerns for a true active manager such as ourselves; next, we will highlight those criteria which we believe require further explanation from the CSA; and finally, we will propose an alternative to the 10 criteria to be used in selecting a reference index.

Reference Fund Criteria That Raise the Greatest Concerns

Please note that for the purpose of drafting our comments contained in this letter, we assumed that none of the mutual funds that we manage have a 10 year track record and, therefore, we considered what would be an appropriate reference index for each of our mutual funds. In some cases, we adopted a blended index and in other cases we adopted a single index. In each case, the use of the reference index selected is consistent with the primary benchmark that we use in the performance discussion contained in the Management Report of Fund Performance ("MRFP") for each of the mutual funds that we manage.[1] All of the data presented below is based on a comparison of a specific mutual fund with the benchmark that forms the basis for discussion in the MRFP of the mutual fund.

Criterion (c): The reference index "contains a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations." This criterion requires there to be not only a high degree of overlap between the portfolio securities of the mutual fund and the constituent securities of the proposed reference index, but also a high degree of overlap in the weightings of individual securities in the mutual fund's portfolio compared with the constituent securities of the proposed reference index. This relationship is best examined by the "active share"[2]; in other words, only if the mutual fund has a low active share relative to the particular proposed reference index will that reference index satisfy this criterion.

Using the primary benchmarks in our MRFPs, as at December 31, 2015, not one Trimark-labelled mutual fund had an active share below 70%. To put this in context, the financial literature generally accepts an active share of 60% as the cut-off between a true active manager and a closet indexer[3]. Of our Trimark-branded funds, 7 had an active share greater than 70%, 8 had an active share greater than 80% and 13 had an active share greater than 90%[4]. More striking, of our Trimark-branded global equity funds, the lowest active share was 89%. Similarly, for our Invesco-branded funds, only 1 had a low active share (50%). Of the remainder, 5 had an active share about 75% and 5 (all of which are global equity funds) had an active share above 80%. We did not repeat this exercise with our PowerShares-branded funds since these are primarily passive, index-based products.

To our knowledge, it is not possible to find reference indices for these mutual funds that would result in the mutual fund having an active share below 60%. We suspect that we are not alone amongst active managers in facing this issue. Accordingly, we strongly urge the CSA to remove this criterion from the Instruction.

We note with interest that the Ontario Securities Commission (the "OSC") recently announced that it is concerned that some investment funds are being promoted as true actively managed funds when, in reality, they are closet index funds.[5] Recently, securities regulators in other parts of the world have also raised this concern. We take note of this because the effect of this criterion, if we have interpreted it correctly, is to dissuade investment fund managers from establishing new actively-managed mutual funds. We submit that is bad public policy and should not be adopted, encouraged or accepted.

Criterion (d): The reference index "has a historical systemic risk profile similar to the mutual fund." Systemic risk is measured by *beta*[6]. This criterion requires the *beta* of the mutual fund to be similar to the *beta* of the proposed reference index. It is simple to conclude that a mutual fund with a *beta* equal to 1 in relation to a particular benchmark, has the same systemic risk as that benchmark. However, such an outcome is at best a remote possibility and the CSA appears to recognize this by using the word "similar".

[1] Note that we typically disclose a broad-based index in the MRFP and either a blend of indices or a more specific but not broad-based index that we believe is more consistent with the mutual fund's objectives and strategies. It is one of these that is typically the primary benchmark upon which we base our discussion.
[2] Investopedia.com defines "active share" as a "measure of the percentage of stock holdings in a manager's portfolio that differ from the benchmark index."
[3] Petajisto, Antti, "Active Share and Mutual Fund Performance", *Financial Analysts Journal*, Vol. 69, No. 4.
[4] This sample constitutes all Trimark funds available to retail investors but only counts each fund once, notwithstanding differences in series available.
[5] *The Globe and Mail*, Friday, March 4, 2016.
[6] http://www.investopedia.com/terms/r/riskmeasures.asp

In our view, systemic risk within 10% of the proposed reference index would meet the criterion of "similar", although we would appreciate if the CSA could clarify this in their response to comments on the Proposed Amendments. On this basis, therefore, we have examined our Trimark and Invesco funds to determine how many would fit within the 0.90 to 1.1 range for *beta*, based on December 31, 2015 data.

First, we examined the *beta* of each of our mutual funds over the 3 year period ending December 31, 2015. In the case of the Trimark-branded funds, only 11 of 28 have a *beta* between 0.9 and 1.1. Therefore, 17 of the 28 Trimark funds could not use the benchmark (blended or otherwise) that they use in the MRFP and in our marketing materials as a reference index under the Proposed Amendments. For the sake of completeness, in the case of the Invesco-branded funds, we found that 9 of 11 funds have a *beta* within the range of 0.9 to 1.1. If the range were increased to 20%, then an additional 7 Trimark funds and 1 Invesco fund would be able to meet this criterion. However, a 20% difference is typically considered "material" both from the perspective of an investor and for purposes of securities legislation. Therefore, it is not clear how 20% could be consistent with the word "similar."

Next, we expanded the analysis to examine the *beta* of each of our mutual funds over the 5 year period (where such exists) ending December 31, 2015. 12 of 25 Trimark funds fell within the 10% range noted above. Of the 13 that fell outside the 10% range, 7 would have fallen within a range set at 20%. For the Invesco funds, 7 of 11 funds fell within the 10% range and all of the funds fell within the 20% range. As such, properly defining "similar" is quite important.

This criterion will prove problematic for some actively-managed funds but not for all and not to the same degree as criterion (c). However, the fact that close to half of our mutual funds overall would not be able to find a reference index that satisfied this criterion suggests to us that this is not a unique issue for our firm. As such, we believe the CSA should re-consider the inclusion of this criterion. Alternatively, the CSA should better define the meaning of "similar". Furthermore, as the measurement period affects the calculation of *beta*, the CSA should provide some guidance as to the appropriate period to measure *beta* for purposes of meeting this criterion.

Criterion (e): The reference index "reflects the market sectors in which the mutual fund is investing." There are at least three ways to interpret the quoted phrase, all of which yield different results. We will set out our three interpretations below with comments relevant to each and ask the CSA to clarify which interpretation is correct.

The first interpretation is that the market sectors in the mutual fund should be included in the reference index but there may be some sectors in the reference index not included in the mutual fund. Furthermore, under this interpretation the sector weightings of the mutual fund relative to the proposed reference index are not relevant. The key point would be that as long as most of the sectors represented in the proposed reference index are found in the mutual fund the proposed reference index would satisfy this criterion. As a result of our investment style, Trimark funds often do not invest in every sector represented by the index nor do our funds invest in anywhere near the weightings that stocks represent in given indices. Therefore, this would be our preferred interpretation. Furthermore, we would prefer an interpretation whereby not less than half of the sectors represented by the proposed reference index are represented in the mutual fund.

The second interpretation of criterion (e) is that the sectors in which the mutual fund invests must all be represented in the proposed reference index and all sectors in the proposed reference index must be invested in by the mutual fund. As in the first interpretation above, the weightings of individual stocks in the reference index would not be relevant. We dislike this interpretation as discussed below.

Under this interpretation, if a mutual fund is exposed to a sector not contained in the proposed reference index or the proposed reference index contains a sector in which the mutual fund is not invested, the proposed reference index would not satisfy this criterion. For the Trimark investment style, this is problematic. For example, Trimark Europlus Fund uses as its benchmark the MSCI Europe Index (C$), a benchmark widely used by investment fund managers for European equity funds. This index, as at September 30, 2015 had a 6.5% weighting in energy, a 5% weighting in telecommunication services and a 4% weighting in utilities. Like all equity indices, it had a 0% weighting to cash. The Fund, in contrast, had a 0% weighting in each of those sectors and an 18% weighting in cash. Therefore, the Fund was not invested in 3 of the 10 sectors represented by the index. This conclusion would apply to 27 of the 28 Trimark-branded funds discussed elsewhere in this letter, with anywhere between 1 and 4 sectors represented in the index used missing from the corresponding mutual fund. We have found that similar concerns arise with many of our Invesco funds.

This interpretation (as well as the third interpretation, below) is inappropriate for a truly actively-managed portfolio as the investment fund manager (in structuring the mutual fund) or the portfolio manager (in managing the investment portfolio of the mutual fund) could find itself in the position of having to alter the investment portfolio of the mutual fund in order to find a reference index that satisfies the criteria contained in the Instruction. Perversely, this could result in one portfolio management approach for the first 10 years of a mutual fund and a different approach, i.e. that which was originally intended, subsequently. Even worse, this could in effect result in a regulation that serves to dictate what investments are made by a mutual fund[7]. We are quite certain that the CSA do not intend this effect but without clarification, this is certainly a possible result.

The third interpretation is the same as the second with the additional requirement that sector allocations are similar. We would be troubled by this interpretation for similar reasons to the previous interpretation. For example, Trimark global equity funds are typically underweight energy and materials and overweight consumer-oriented sectors, often by double-digit percentage points. If this interpretation prevails, we would have no choice but to commission new indices for those mutual funds and, as discussed below, it is not clear that an acceptable reference index can even be created.

Criterion (f): The reference index "has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets". We interpret this as meaning that the average weighting of a constituent security in a proposed reference index should be roughly the same size as the average weighting of securities in a mutual fund's portfolio. For example, if the index typically has an average weighting of 0.5% for each constituent but the mutual fund runs a concentrated portfolio with a 4% weighting for each portfolio security, the proposed reference index would not satisfy this criterion. This presents a problem for the Trimark funds because one of the primary differentiators of the Trimark investment style is to run concentrated portfolios, which could have as few as 25 portfolio holdings and as many as 50 (in most cases). This approach implies an average weighting of 2% to 4% for portfolio securities held in Trimark

[7] We make this point because, in creating new mutual funds following implementation of the Proposed Amendments, the investment fund manager cannot even file a simplified prospectus and fund facts document without a risk classification, which depends on finding an appropriate reference index. Therefore, if an appropriate reference index does not exist for a new mutual fund, the mutual fund could never file compliant disclosure documents.

funds. In contrast, the S&P 500 Index, as the name implies, has an average weighting of 0.2%. The MSCI Europe Index, with 446 stocks has an average weighting of 0.2% and the S&P/TSX Composite Index, with 239 stocks has an average weighting of 0.4%. We would expect most new global equity funds to consider using the MSCI World Index as its reference index. However, that index has 1650 constituent securities and, as such, one would not expect that such index could satisfy this criterion. Based on the foregoing, it seems evident to us that it would be extraordinarily difficult, if not impossible, for a mutual fund with a concentrated portfolio to find a reference index that meets this criterion.

Criteria That Require Further Clarification

Criterion (a): The reference index "is made up of one or a composite of several market indices that best reflect the returns and volatility of the mutual fund and the portfolio of the mutual fund." In our opinion, this is a very vague statement. We seek CSA guidance on the meaning of "best reflect the returns and volatility" of the mutual fund and we do not understand the distinction drawn in the criterion between "the mutual fund" and "the portfolio of the mutual fund."

Criterion (b): The reference index "has returns highly correlated to the returns of the mutual fund." The phrase "highly correlated" is ill-defined in Canadian securities legislation and, as a result, leads to high degree of different interpretations and, hence, different applications. The best example of this is the use of the phrase in the definition of "hedging" in NI 81-102. Some portfolio managers believe the high negative correlation requirement in that definition is satisfied at a negative 60% correlation, while others use 70% or 75%. (We are not aware of any who use a higher number than that although our sampling on this is not statistically significant.)

Criteria (h) and (j): The reference index "has its returns computed on the same basis (e.g. total return, net of withholding taxes, etc.) as the mutual fund's returns" and "is based on an index or indices that have each been adjusted by its index provider to include the reinvestment of all income and capital gains distributors in additional securities of the mutual fund." We read each of these criteria as requiring the reference index to be computed on a total return basis with perhaps the sole difference being that if the mutual fund makes other deductions in computing NAV (such as taxes) then the proposed reference index has to as well. If that is the case, it is not clear to us why two criteria are used instead of just one, i.e. use a reference index that is computed in the same manner as a mutual fund is required to calculate performance, as set forth in section 15.10 of NI 81-102.

Potential Solutions

It is simply not possible for a reference index to have return and portfolio characteristics similar to those of an actively managed mutual fund that is not, in reality, a closet index fund.

In previous discussions with Staff at the OSC, we have been advised that there is nothing in the rule that prevents a manager from commissioning an index in order to meet these criteria. Oddly, at the time that comment was made to us, the proposal on the table required a reference index to be widely quoted and available. We criticized that in our previous comments and we are pleased that the CSA accepted such comments. However, it appears to us that the CSA has not closed the door to this solution due to Criterion (i) of the Instruction which requires that any index used for these purposes be created and administered by an unaffiliated third party. As an investment fund manager that also offers exchange-traded funds, we are familiar with index creation and maintenance. Significant fees may be involved and it might even be impossible to create the desired index. At this stage, based on our discussions with index providers, they simply have not turned their minds to this issue as we are unable to even get price quotes from the providers to determine what our costs might be to create compliant reference indices. What we do know is that the simplest of indices would cost a minimum of $5,000 to $15,000 to create (that does not include annual maintenance) and that the price increases with each additional element of complexity. As shown above, we would need many elements of complexity for a compliant reference index to be used in creating risk classification ratings for Trimark funds with a track record less than 10 years. If this expenditure created something of value for mutual fund investors, it would be difficult to argue that the expenditure is not worth the money, but that is not the case. Risk classification itself is an inherently inexact endeavour. The Proposed Amendments already take a complex subject-matter and try to break it down to something that a financially illiterate individual could understand. Even though the standard deviations of mutual funds might range from 0% to as high as 30%, this gets distilled into 5 categories. To make matters worse, instead of giving an indication as to what the standard deviation is for a particular mutual fund, this gets translated into a label: low, low to medium, medium, etc. In light of that, it is startling that the CSA would continue to push for such exactitude on a reference index. We note that the IFIC Risk Classification Guidelines, upon which the Proposed Amendments are obviously based, does not have such a requirement and for good reason: it is expensive and cumbersome to administer and does not provide any better information for an investor.

As things stand today, every mutual fund is required to select one of more benchmarks upon which to compare their performance in the MRFP. The criteria relating to the use of the index are simple to apply. Fund managers are permitted to create their own blends to create a benchmark that provides a better comparison, as long as a broad-based market index is also used. It is really these blended indices that would provide the best proxy as a reference index for purposes of the Proposed Amendments: not because they provide more exactness but because they are easy to use and simple to administer and the “leakage” of precision compared to the 10 criteria for a reference index do not make a significant difference to the outcome.

As such, we propose the following:

- Subject to providing proper explanation of criteria (a) and (b) as discussed above, maintain those criteria;

- Maintain criteria (g) and (i);

- Replace criteria (h) and (j) with a requirement that the performance of the reference index be calculated in the same manner as a mutual fund is required to calculate performance under section 15.10 of NI 81-102;

- Explicitly state that the reference index for use in this context can be the index used for the benchmark in the MRFP and that if a benchmark is used in addition to the broad-based benchmark, the additional benchmark should be used as the reference index;

- Explicitly state that an investment fund manager that uses the MRFP benchmark will be deemed to be in full compliance with applicable regulation and that such use offers the investment fund manager a full defense to any claims of misrepresentation relating to the use of reference index data;

- Provide for at least a 1 year transition period to allow truly active managers sufficient time to consider an alternative and apply to their principal regulator for relief from this requirement.

If the list of criteria contained in the Instruction is maintained then it is incumbent upon the CSA to provide further guidance, in the form of a Companion Policy, stating what it means by the opening words of the Instruction, namely that a "mutual fund should consider". The plain meaning of that phrase is that the mutual fund should consider the criteria but may freely choose not to apply the criteria after such thought has been given and without fear of regulatory repercussion. If that is the case, then it would be helpful to all to so state and this (and I suspect other similar) comment letters serve no purpose other than to remind the CSA of the need for clarity and precision in drafting rule proposals. One might also interpret the phrase as meaning that the CSA expects most, but not all, of the criteria to be met for a reference index selection. Even if that is the case, such clarity would be helpful. It is not clear to us why the CSA would not provide that.

Thank you for providing us with the opportunity to comment on this important initiative. We would be pleased to discuss our comments further should you so desire.

Yours very truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President and Head of Legal – Canada

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March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

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Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

RE: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 *Investment Funds* and related Consequential Amendments (the "Proposed Amendments")

Thank you for the opportunity to provide comments to the Canadian Securities Administrators (**"CSA"**) on the Proposed Amendments.

Fidelity Investments Canada ULC ("**Fidelity**", "**we**", "**our**" or "**us**") is part of the Fidelity Investments organization in Boston, one of the world's largest financial services providers. Fidelity currently manages over $112 billion in mutual funds and institutional assets and offers approximately 200 mutual funds and pooled funds to Canadian investors.

Please find below our executive summary as well as our general and specific comments on the Proposed Amendments.

EXECUTIVE SUMMARY

We support the CSA's revised standardized risk classification methodology. We are happy that the CSA decided to extend the application of the Proposed Amendments to exchange-traded funds ("**ETFs**"). This will allow investors to more meaningfully compare risk between mutual funds and ETFs. We encourage the CSA to work with the insurance regulators to recommend the same risk methodology be used to measure the overall risk of segregated funds, a large percentage of which in Canada invest in underlying mutual funds. Retail investors will be better off if they can easily compare all like products together before making investment decisions.

GENERAL COMMENTS

Use of a reference index for funds that have less than 10-years of performance history

The CSA proposes the use of a reference index to be used as a proxy for funds that do not have a 10-year performance history. We agree with this approach. However, we believe that not all of the guiding principles provided contribute to the most important criteria of index selection; specifically that the reference index have returns that are expected to be highly correlated to the fund and that the reference index have risk and return characteristics similar to the fund. In our view, it would be difficult, if not impossible, to identify indices that meet all of the criteria listed.

(b) has returns highly correlated to the returns of the mutual fund

Some funds, like new or young funds, do not have a performance track record from which to calculate correlation. Therefore, we believe that the wording of this principle should be revised to read "has returns expected to be highly correlated to the returns of the mutual fund", and we would also add "has risk and return characteristics that are expected to be similar to the mutual fund".

(c) contains a high proportion of the securities represented in the mutual fund's portfolio with similar allocations

A proxy index that best represents a fund's volatility may not necessarily contain a high proportion of securities represented in the fund's portfolio. For example, the MSCI All Country World Index ("MSCI ACW Index") has over 2,300 securities listed, whereas an actively managed fund that uses the MSCI ACW Index as its benchmark index may have a much smaller proportion of securities held. In this and in other similar circumstances, the selection of the MSCI ACW Index would not necessarily contribute to the objective of using a proxy index that best represents the expected volatility risk of the fund. Therefore, we believe this principle should be removed.

(f) has security allocations that present invested position sizes on a similar pro rata basis to the mutual fund's total assets

We believe that only index mutual funds would be able to meet this criterion. Therefore, we believe this principle should also be removed.

The index used in a fund's management report of fund performance can also be used as a proxy to determine a fund's risk rating

In addition, the CSA has said that the index or indices used in a fund's management report of fund performance ("**MRFP**") can also be used as a proxy to determine the investment risk level of the fund, if the index or indices meet the principles set out in the Proposed Amendments. We are of the view that this would, in some cases, lead to the inappropriate selection of a reference index.

The MRFP guidance for the use of a "broad-based securities market index" is not, in our view, designed to fulfill the fundamental selection criteria of "high correlation" and have risk and return characteristics similar to the fund. Rather, it was designed to provide a broad market proxy for comparison. In many circumstances, a fund's best fit "broad-based securities market index" may be neither highly correlated to the expected returns of the fund nor have risk and return characteristics expected to be similar to the fund. Accordingly, we recommend that this guidance be removed or clarified.

SPECIFIC COMMENTS

We have reviewed the specific amendments to NI 81-102 contained in Annex B of the Proposed Amendments. In addition to our suggested changes outlined above in our general comments, we suggest the following revisions:

(1) All Items

We believe that the word "annualized" should be inserted immediately before the term "standard deviation" is referenced. This would ensure consistency with the stated standard deviation formula to be used (i.e. the formula annualizes standard deviation of monthly returns).

(2) Item 4 Mutual Funds with less than 10 years of history

Subsection 2(b) mandates that fund managers disclose in its prospectus a brief description of the reference index, if used, and if the reference index has changed since the last disclosure, details of when and why the change was made.

We acknowledge that the purpose of the Proposed Amendments is to adopt a standardized methodology that is consistently applied across funds and ETFs. If a reference index is used or changed by a fund, the disclosure requirements in subsection

2(b) leaves open the opportunity to be interpreted and applied differently by fund managers. We ask that the CSA provide sample wording of what would be acceptable disclosure for the use of or change in a reference index.

CONCLUSION

Fidelity fully supports the revised risk methodology as set out in the Proposed Amendments. However, we are concerned that the criteria provided for using a reference index are too restrictive and practically unworkable. We believe that the conditions for reference index selection must be sufficiently flexible to source an appropriate risk proxy with emphasis on selecting a volatility proxy expected to be highly correlated with the investment fund and exhibit materially similar return and risk characteristics.

We thank you for the opportunity to comment on the Proposed Amendments. As always, we are more than willing to meet with you to discuss any of our comments or provide any further examples.

Yours truly,

"Robert Sklar"

Robert I. Sklar
Senior Legal Counsel
Fidelity Investments Canada ULC

"John Wilson"

John Wilson
Vice President, Product Research
Fidelity Investments Canada ULC

c.c. Rob Strickland, President
W. Sian Burgess, Senior Vice President, Fund Oversight
Edward McLaughlin, Director, Product Research
Robyn Mendelson, Vice President, Legal

PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

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The Secretary
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comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments

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The Portfolio Management Association of Canada (“PMAC")[1], through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to respond to the proposed amendments for Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts (the “Proposal”). PMAC has generally been supportive of the CSA’s direction on mutual fund risk classification and the use of standard deviation. We are also supportive of some of the key changes from the 2013 proposal including the elimination of the six-category risk scale presented in the 2013 Proposal, to the standard five-category risk scale from low to high currently in the Fund Facts and in the proposed ETF Facts.

[1] PMAC was established in 1952 and currently represents over 220 investment management firms that manage total assets in excess of $1.4 trillion. PMAC Members are registered portfolio managers with the Canadian securities regulators as well as, in many cases, registered investment fund managers and exempt market dealers. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

Proposed Reference Index

Our main concern with the Proposal is the proposed reference index for mutual funds and ETFs without a 10 year return history (the "Proposed Reference Index"). In our view, many investment fund managers, who have concentrated portfolios or who are true active managers, will struggle with finding appropriate indices for their funds in light of several of the principles listed in the Proposed Reference Index. For some of our Members, the only way to comply with the principles included in the Proposed Reference Index will be to engage an unaffiliated third party to create appropriate reference indices. This would be prohibitively expensive and complex. In addition, as the regulators are aware, ten year return data does not exist for a significant portion of mutual funds/ETF's in Canada. By substituting an index for actual fund performance, the disclosed risk of the fund may be overstated or understated and this problem will be greater the younger a fund is because the younger the fund the more years of reference index performance it will have to use. In many cases, the use of a reference index won't necessarily provide an accurate representation of the fund's risk.

Our Members have expressed concerns with specific principles. For example, principle (c) *which requires the reference index to "contain a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations*" is problematic because if interpreted to mean only if the mutual fund has a low active share relative to a particular proposed reference index will that reference index be acceptable, for some of our Members, their funds would not have an appropriate active share ratio and it would be impossible to meet this principle. Similarly, principle (d), which requires the reference index to "*have a historical systemic risk profile highly similar to the mutual fund*", will also be problematic for some actively-managed funds because it may not be possible to come within the "beta" range. We believe the CSA should re-consider the inclusion of these principles and others potentially for similar reasons.

We also strongly believe that certain of the principles require further clarification. For example, principle (b) "*has returns highly correlated to the returns of the mutual fund*" is not clear. We query the meaning of "highly correlated" in the context of the Proposed Reference Index and note that there is no current widely accepted industry standard as to how to establish high correlation. Further clarity as to what is expected here would be beneficial.

We also note that the Proposed Reference Index also does not take into account the permitted investments that many 81-102 mutual funds are permitted to undertake (i.e. short selling, derivatives, etc.). These are not accounted for in any of the reference indexes that are available.

Indices Used in the Management Report of Fund Performance (MRFP)

The Proposal indicates that an index or indices used in the management report of fund performance (MRFP) in Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* can also be used as a proxy to determine the investment risk level of the mutual fund, if the index or indices meet the principles set out in the Proposed Methodology. While for some active funds, the use of the index used in the MRFP may be acceptable, for many funds it will not be as the Proposed Reference Index requires far more to be captured. For example, Instruction (1) of Item 4.3 of 81-106F1 provides that an appropriate broad-based index is one that is administered by an unaffiliated entity (unless it is widely recognized and used) and which has been adjusted to reflect dividend reinvestments. The principles in the Proposed Reference Index go far beyond this.

Similarly, Instruction (3) of item 4.3 of 81-106F1 states that if one is going to optionally compare oneself to a financial or narrowly-based securities index then that index must reflect the market sectors in which the fund invests or provide comparatives to the performance of the fund. These criteria are far more manageable and easier to comply with than the principles set out in the Proposed Reference Index. For example, the principle listed under paragraph (c) of the Proposed Reference Index indicates that the index must contain "a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations". Unless a fund is an index fund, we do not believe that any fund can find an index that meets that principle unless it is customized.

Recommendations

We believe the Proposed Reference Index should be more flexible to ensure funds can meet the listed principles. We also believe the principles need to be better defined and clearly understood. For this reason, we recommend the CSA consider whether certain criteria should be removed from the Proposed Reference Index to ensure investment fund managers can meet the principles without compromising the accuracy and reliability of the fund's risk rating. In this regard, we also believe the principles need to be less prescriptive and less onerous. We recommend the CSA publish guidance for comment to provide more details and clarity around what is expected in meeting the principles in the Proposed Reference Index. This would enable the industry to clarify its interpretation of certain concepts referred to in the principles and would level the playing field in ensuring all fund managers are interpreting and applying the principles in a consistent and appropriate manner.

While we believe that generally, the Proposal will provide for greater transparency and consistency, and enable investors to evaluate and compare the investment risk levels of mutual funds and ETFs, certain aspects of the Proposal, namely the Proposed Reference Index, is problematic for certain fund managers and must be revisited to ensure it will actually accomplish was it is designed to do and meet the policy objectives of the regulators.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@portfoliomanagement.org) at (416) 504-7018 or Julie Cordeiro (jcordeiro@portfoliomanagement.org) at (416) 504-1118.

Yours truly;

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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March 9, 2016

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Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comments *CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts Proposed Amendments to National Instrument 81-102 Investment Funds and Related Consequential Amendments* – published for comment December 10, 2015

We are pleased to provide the members of the Canadian Securities Administrators (CSA) with comments on the proposed amendments to the various instruments as published for comment in the above-noted CSA Notice. Our comments are those of individual lawyers in the Investment Management practice group of Borden Ladner Gervais LLP and do not necessarily represent the views of BLG, other BLG lawyers or our clients.

We are overall very pleased with the proposed rule amendments which took into account the many substantive comments that were made on the original proposals published for comment with CSA Notice 81-324 in December 2013. Our more substantive comments were addressed by the proposed amendments to the various instruments.

Overall, as we noted in our December 2013 comment letter, we understand the policy rationale that would lead the CSA to consider mandating one standardized method for disclosing the risks associated with mutual funds. While we have no particular expertise on the specifics of the various different methodologies, we understand that standard deviation is generally considered to be a good proxy for measuring the volatility of a mutual fund, which may be perceived of as "risk" – and we generally support the concept of the CSA choosing this one methodology and requiring all mutual funds to base their risk assessment on that measurement methodology (although we note that some mutual funds and their managers may wish to use a different methodology than one that measures "volatility" having regard to the specialized nature of the mutual fund – please see our comments 6 and 7 below).

We have the following comments on the proposed rule amendments.

Application to ETFs

1. We have no issue from a policy perspective with the CSA expanding the investment risk classification methodology to ETFs, although we note that the amendments as they apply to ETFs cannot come into force until such time as the ETF Facts document and rule proposals are completed. We urge the CSA to clarify that an ETF does not have to immediately amend their ETF Facts document (many already use a summary document) in order to disclose their investment risk (according to the new rules), until the next renewal, provided there is at least six months between the coming into force of the amendments and the next renewal. Anything else would be burdensome and unnecessary having regard to the length of time both the ETF Facts document and the risk methodology have been in development by the CSA.

Need for Careful Consideration of Transition to Any New Regime

2. It is unclear what the CSA propose by way of transition. Similar to our comment above, we urge the CSA to clarify explicitly that the first annual review of the investment risk (according to the new methodology and rules) must take place at the time of the next renewal of the funds' prospectuses, provided that there is at least **six months** between the coming into force of these amendments and the funds' next renewal. As we pointed out in our December 2013 comment letter, in thinking about transition, it is of utmost importance that the CSA keep in mind:

   (a) It is burdensome for mutual funds and their managers to revise the templates used to create Fund Facts, as well as for dealers and advisors to understand the changes made to the Fund Facts so they can use them with their clients.

   (b) Fund managers will need to institute systems for calculating and monitoring, and keeping records of same, regarding the new methodology. This takes time and resources, and when factoring in other regulatory changes, needs to be implemented thoughtfully.

(c) It will be important for the CSA to monitor the dates when most funds renew their prospectuses – being the spring and into the summer months – if the rule comes into force too closely with this renewal season, these fund managers will have insufficient time to prepare for compliance with the new rules and should be provided with longer transition timing in order to lessen the regulatory burden. To be clear, we recommend a longer transition timing for all fund managers regardless of renewal of their prospectus.

(d) The ongoing work within the industry to comply with CRM-2 requirements that came into force in July 2013. These requirements impact all registrants – including fund managers and distributors of mutual funds. Effective implementation of CRM-2 absolutely must take precedence to the CSA's efforts in this area, given the nature of the significant changes required by the CRM-2 requirements, as well as the continuing uncertainty on aspects on how to apply certain of the requirements and avoid unintended consequences.

(e) We also point out that the recent choice of the CSA of mid-month dates, such as May 13 and June 13 (Fund Facts) and July 15 (CRM-2), has significant implications for industry participants and we urge the CSA to return to using calendar month-end dates, as well as dates that have a logical linkage to the new requirements and common industry timing, in order to ease transition.

Our emphasis on the need for an appropriate transition period, as well as an adequate period of time to implement any new rules is coloured by our experience with the amendments to the Fund Facts requirements that became effective in September 2013, which we described in our December 2013 comment letter. We strongly urge a recognition of the additional regulatory burden that resulted from the transition required by that rule to avoid the same issues with the implementation of these rule amendments.

Monitoring of Standard Deviation

3. We are pleased that the CSA pulled back from requiring monthly monitoring of standard deviation calculations for each mutual fund. An annual monitoring, in conjunction with the renewal of the mutual funds' prospectus, appears to us to be the maximum that should be mandated, with ad hoc review in the discretion of the fund manager as a result of material changes to the fund that could impact its rating. This is consistent with current industry practice and the IFIC Guidelines and makes logical sense, given that the renewal must contain updated information about the mutual funds and all other information is updated annually.

We are concerned however that the amendments to the Fund Facts Form (in Appendix C to the CSA Notice) will necessitate a review of the investment risk of each fund at any updating of Fund Facts documents outside of the annual prospectus renewal ("risk classification must be within 60 days before the date of the Fund Facts document"). We urge the CSA to specifically explain that this does not mean that fund managers must review and update the calculation at the time of filing of an amendment to the Fund Facts (which is necessary in conjunction with a material change to the Fund which is unlikely to impact the risk rating of the fund), but they should consider whether the change would alter the risk rating. The annual review is sufficient in our view and is the maximum that should be required.

4. We agree with the concept that a fund manager should determine the risk rating of the Fund as a whole, rather than series by series and commend the CSA for keeping this concept in the proposed amendments.

Reference Index for Mutual Funds with Less than 10 Year History

5. The CSA propose guidance about the appropriate "reference index" to use if a mutual fund does not have a 10 year performance history. We continue to urge the CSA to consider the following issues, among others, that may be raised by industry participants that are more familiar with the methodology to calculate standard deviation:

   (a) We consider that the fund manager should have discretion to choose a reference index that it considers appropriate – it is not necessary to mandate specifics around this issue, given the fund manager's overall fiduciary responsibilities. If the CSA feel they need to be prescriptive (and we recommend the CSA explain why they need to be prescriptive), we question the CSA's guidance in Item 4 of Appendix F to NI 81-102 about the reference index.

      (i) How can the returns of an index be highly correlated to the returns of the mutual fund, when the mutual fund does not have any returns (a new fund) or does not have the returns for the same time periods as the index? Also, if a fund is actively managed, it may not be "highly correlated" to an index. Most actively managed funds seek to outperform or perform differently that their benchmark index.

      (ii) How will a fund manager determine whether or not an index will have a "historic systemic risk profile" highly similar to the fund – what does this mean? And how will this apply to a new mutual fund?

      (iii) How can a fund manager determine whether the index "has security allocations" that represented invested position sizes on a similar pro rata basis to the mutual fund's total assets. How will this apply to a new mutual fund?

   (b) In our view, a fund manager must be able to use its discretion to use an appropriate reference index, even where a mutual fund has 10 years of performance data, in cases where there has been a fundamental change to the mutual fund and/or for any other reason the fund's past returns are not representative of the fund's current attributes. Item 5 of Appendix F does not clearly explain this or even reference it.

(c) We also urge the CSA to explicitly permit the fund manager to use its discretion to determine the risk rating for a fund with less than 10 years performance history, where the reference index may suggest a higher volatility, but the manager is able to show qualitatively and quantitatively that the fund belongs in a lower category.

6. We continue to consider that additional thought should be undertaken regarding "indices" and the CSA's requirements for such in general – NI 81-101 mandates comparisons to an index in Fund Facts documents, as does NI 81-106 for continuous disclosure purposes and now Appendix F to NI 81-102 for risk classification purposes. In each circumstance, the definitions and guidance is slightly different – and we do not understand why that would be the case, particularly since the differing rules could result in a fund being compared to a different index (pursuant to the NI 81-106 documents and the fund facts) from that used as a reference index for risk circumstances. We consider the same (streamlined) guidance as to an appropriate index should be the same for all three usages of same.

Need to Allow for Fund Manager Discretion

7. The CSA's proposed methodology uses a quantitative process and does not permit any deviation, exercise of discretion or qualitative analysis by the fund manager, unless it decides to move the risk rating up to a *higher* risk classification. There may be many non-measureable risks, such as portfolio manager changes, relative liquidity of certain investments or a sector specific or global financial crisis, where discretion of the fund manager will be important to provide an accurate depiction of risk to the potential investors. We believe that fund managers should be encouraged to apply discretion prudently to raise or lower the risk, the latter we understand the CSA's proposals would not permit. In our experience fund managers are generally in the best position to assess non-measurable or unquantifiable risks and how they apply to a fund.

8. We urge the CSA to recognize that there may be speciality mutual funds for which standard deviation is not the correct measurement of risk – in that volatility is not the right measurement of risk to reflect the actual risk profile of the mutual funds.

   Precious metals mutual funds, including mutual funds that invest in gold, are the best example of this issue, given that the price of the underlying assets are inherently volatile. Volatility is not an appropriate measure of risk for gold because it has intrinsic value (i.e. it does not have the potential to have NIL value like a stock or bond). Gold also provides protection against falling equity prices and has low historical correlation with other asset classes and therefore represents an alternative holding as part of an overall wealth protection strategy.

   We recommend that further consultation be conducted and the proposed rules acknowledge the circumstances when a fund manager may wish to use another appropriate measurement of risk. At the very least, the rules should recognize the inapplicability of standard deviation to mutual funds that invest in precious metals and permit the fund manager to use a measurement that is more tailored to the specific mutual fund. We note that this result would be permitted by the IFIC Guidelines.

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We thank you for allowing us the opportunity to comment on the proposals set out in the CSA Notice. Please contact any of the following lawyers at the contact details provided below if the CSA members would like further elaboration of our comments. We, together with other BLG lawyers who have considered the proposals, would be pleased to meet with you at your convenience.

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Yours very truly,

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OSC Investor Advisory Panel
c/o Ursula Menke, Chair
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February 19, 2016

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Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments

The Investor Advisory Panel is pleased to respond to the Canadian Securities Administrator's proposed amendments for its Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts. We see the prescribed methodology as a major step forward in eliminating subjectivity in the calculation of risk rating – from the perspective of investors, it will provide consistency, transparency, and the ability to compare products. We are also pleased to see regulators proposing to apply the same methodology to both mutual funds and exchange-traded funds ("ETFs").

We do, however, have some concerns and suggestions for the CSA as it moves forward to refine the risk categorization. Our recommendations echo and build upon concerns previously outlined in our comment letter to the CSA submitted on March 7, 2014, where we expressed our views on the shortcomings of standard deviation as a single measure of a fund's risk.

We have made several proposed recommendations below:

Representing Standard Deviation – In the proposed methodology, a mutual fund or ETF will be given an investment risk level that corresponds to a standard deviation range – low (0 to less than 6), low to medium (6 to less than 11), medium, (11 to less than 16), medium to high (16 to less than 20), and high (20 or greater). This approach, however, is less precise than the calculated outcome – and it dilutes the results, providing less accurate volatility information to investors.

Recommendation – Find a way to represent the full spectrum of standard deviation calculations numerically rather than assigning a high-low rating system that is less transparent and accurate. In addition, explain concretely what that number actually means to the investor.

Performance history – Standard deviation is a measure of price volatility, but does not show actual loss of capital. While standard deviation may be seen as a component of risk assessment, volatility alone does not represent the risk level of a fund. Additional factors to consider include probability and potential maximum loss of capital (e.g., based on a maximum 10-year performance history). Moreover, standard deviation may not capture true volatility in some exotic ETFs that use complex strategies nor does it capture the risks in products such as life cycle and return of capital funds.

Recommendation – In addition to standard deviation, include bar charts that show (absolute) worst (3-month period) and best (3-month period) performance during the life of the fund with a maximum of 10 years. The Panel would like to again refer the CSA to the alternative proposed in our March 7, 2014, comment letter. Also, consider showing the number of trading days where price changes were greater than 1% during the life of the fund with a maximum of 10 years.

Tail risk – Standard deviation assumes a normal distribution (curve) which does not address how a fund behaves in extreme market conditions (i.e., 2001, 2008, 2015). Fat tails can impact the performance of a fund and lead to extreme losses– that puts investors at risk. We encourage the CSA to follow more up-to-date comprehensive measures being developed and explored by large financial institutions, specifically the use of "expected shortfall" (or Conditional VaR (CVAR)).

Recommendation – Consider warning investors that not all investments have a normal return distribution – and that market conditions can change suddenly and can increase volatility unexpectedly. The frequency of sudden unexpected changes in capital market conditions has been increasing over the past three decades.

Standard deviation not the only measure of risk - While the IAP agrees that standard deviation may be one aspect of risk assessment, it should not be the only one. We are concerned that the CSA is focused solely on standard deviation as an adequate measure of a fund's risk. In addition to volatility, the CSA must consider listing additional risk elements, where applicable, so that investors have an appreciation of the different types of risks associated with their investment (e.g., liquidity, leverage, duration, holding period, inflation).

Recommendation – Broaden the spectrum of risk assessment aspects to be disclosed. For fixed income funds add duration (to measure the sensitivity of the price to a change in interest rates), and disclosure of issuer and risk rating of holdings.

Address liquidity risk (i.e., indicator of the fund's ability to meet unit/shareholder redemption requests and dilutive impact of significant size buy and/or sell transactions). We realize that development of a standard method to calculate liquidity risk is complex and will take time. We urge the CSA to review the work the U.S. Securities and Exchange Commission (SEC) has undertaken towards mandating adequate liquidity risk disclosure and to strive to mandate a metric for this disclosure in due course concurrent with the SEC. Until such time a metric will have been decided on and mandated, the investor should be made aware of liquidity risk through a brief description.

Where applicable, disclose additional risks (including a description) such as counterparty risk, currency risk, concentration risk, interest rate risk, operational risk, strategy (complexity) risk (e.g., use of derivatives, hedges, or short selling), regulation risk, leverage risk, as well as fund-specific risks, such as risks applicable to life cycle funds or return of capital funds, and authorized participant concentration risk for ETFs (in other words, when an ETF is overly reliant on a small number of authorized participants to generate liquidity and avoid tracking error). Depending on the fund, some should be highlighted, others may be cross referenced to the risk section in the prospectus.

If the pertinent section only shows standard deviation, we recommend that it be more appropriately referred to as "volatility" rather than "risk".

Use of blended historical data - The Panel is deeply concerned with the CSA's acceptance of blended historical data in cases where a fund does not have actual historical data for a period of 10 years. Where a fund does not have the required historical data, actual fund data should never be combined /blended with proxy/reference index data. Such a practice could be or could be seen at best as misleading, at worst as misrepresentation.

Recommendation: Use actual historical fund data for the period that they are available, and show the outcome specifying the period; in addition, separately show the applicable proxy/reference index data for the required 10-year period, specifying the proxy/index.

Basis for calculation - We agree with the CSA on using NAV for calculation, provided that the impact of MER on return will be clearly shown.

Conclusion

While the Panel continues to support prospectus summary documents and is pleased with the proposed mandate, we urge CSA to continue working towards enhancing the risk disclosure mandate to make it more comprehensive, and meaningful to the investor.

By email January 10, 2016

S. Fortier Commentary

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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I appreciate the opportunity to comment on the fund risk rating methodology. I am responding as an investor rather than as a lawyer, statistician or regulator so my views may be quite different than those from industry people. It is neither fair nor reasonable to comment on this methodology in a vacuum. Comments must relate to how this methodology integrates with Fund Facts (FF's).

As I read the consultation paper, it appears evident it has been written by those who sell mutual funds rather than those who buy mutual funds. Investors buy mutual funds for the long term, thus monthly changes in return are of little concern. For those saving for retirement, it is the downside risk that matters. People want to know that investing in mutual funds will allow them to meet their goals when they need the money. Hence volatility is not risk.

People also don't want to buy high and sell low and that is what a good risk disclosure should prevent them from doing. Bond mutual funds typically make up over 40% of a portfolio - virtually all are currently rated LOW risk. What happens if interest rates rise? Am I buying near a high?

I truly worry about the efficacy of this methodology but it appears that the CSA has already selected it so my comments may have little relevance.

In any event, here are my comments:

<u>Number of risk bands:</u> I believe the number should be at least six; in Europe they use seven in order to prevent huddling together under one risk heading. I do not comprehend why the CSA recommended 6 but now has reverted to the 5 in the IFIC system.

<u>Time period</u>: Ten years seems reasonable as it should contain at least one market downturn.

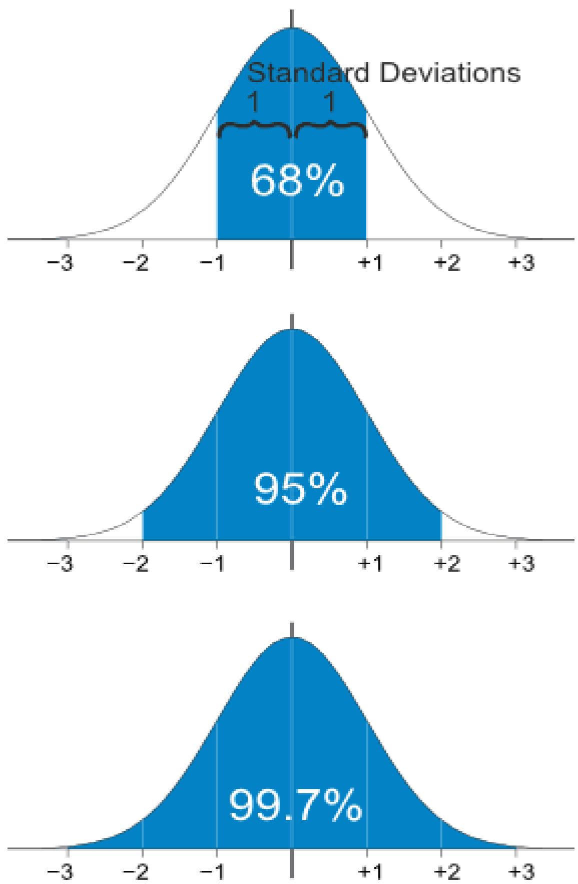
<u>Medium risk is meaningless</u> : From the perspective of a retail investor, the word **Medium** risk is misleading. If you look at a random selection of Canadian and U.S. equity funds, many of the losses in 2008 exceeded 40% yet they are rated **Medium** risk under the current rating system .

To many people, Medium risk means “average” which makes little sense, and average risk means even less to the typical Canadian investor. Comparing two funds each with a Medium rating is a futile, sterile exercise. According to the bands proposed, if a fund with a Medium rating had a mean 7% return, it could vary between -15 percent and 29 percent , 95 % of the time at the low-end of the range, and between -25 percent and 39 percent at the High end. Clearly, adding numerics highlights these sorts of significant differences. This is why I recommend that the actual standard deviation number be provided - ideally on a thermometer type scale ranging from 1 to 10 with 10 being the highest risk in lieu of fixed bands.

<u>Use of words as risk level nomenclatures</u>: This can and has led to investor confusion. I recommend a numeric scale from 1-10 as people interpret words differently especially when the words have no context for the average investor. The European system uses a numeric scale from 1-7. The Securities and Exchange Commission, interestingly, does not use fund ratings because they believe it can lead to investor confusion.

<u>Use of proxy data</u>: It seems to me that only a fraction of mutual funds in Canada survive 10 years. This means that a large fraction of funds will not be reporting their true SD, which makes the methodology kind of silly in those instances, and possibly misleading to investors who aren't even told that the figures/ratings are fabricated.

<u>SD/Normal curve not really representative of risk</u>: I note that numerous commenters have expressed in their previous submissions on the Point of Sale project that volatility (risk) is only one of the material risks that an investor should consider before making an investing decision. One of the risks that weigh heaviest on the minds of most consumers is the risk of losing their initial investment or not meeting their financial objectives. But the returns of a mutual fund that loses 10% of its value each and every month would have a standard deviation of zero and would be classified as low risk under the Proposed Methodology, even though such an investment would lose nearly all of its value over the course of 12 months. I find it unlikely that most retail investors would consider such investments to be "low risk" propositions. I certainly wouldn't. I also doubt whether most fund investors have a mental picture of the underlying distribution so they can interpret volatility.



In addition, the volatility rating methodology is based on the well-behaved Normal distribution. In the real world, Skewness and kurtosis are important because few real world investment returns are Normally distributed as assumed by the CSA. These tail risks distort the left tail which of course will understate true risk. The Ontario Securities Commission Investor Advisory Panel Comment letter https://www.osc.gov.on.ca/documents/en/Securities-Category8-

Comments/com_20140307_81-324_iap.pdf contains some very good ideas on risk disclosure that should be considered. I can relate to that kind of disclosure. A recent research paper **A Risk and Complexity Rating Framework for Investment Products** http://skbi.smu.edu.sg/sites/default/files/skbife/A_Risk_and_Complexity_Rating_Framework_for_Investment_Products_July_2014_final.pdf also contains some interesting approaches to risk rating that might be of interest to the CSA .

Be clear on "Representative risk ": About half the cost of buying a mutual fund includes paying for investment advice (typically a 1% trailer sales commission). This advice element is not captured by the monthly standard deviation movements resulting from market dynamics. In fact, the advice may not even be provided as in the case when a fund is bought via a discount broker, it may be provided but at a level of effort well below what is being paid for and in the worst and very common case, the advice may be conflicted and work against the best interests of clients.

The statement" *Higher commissions can influence representatives to recommend one investment over another* "has got to be the understatement of 2015! " Can " makes it sound like it could happen, sort of maybe ... whereas the reality is that conflicted advice is widespread. According to overwhelming research, including the CSA's own ,trailer commissions influence not only the recommendations made but also those not made (eg paying down debt , increasing life insurance etc.) I strongly urge the CSA to make this warning much stronger emphasizing the conflict-of-interest between the representative (receiving money from the fund manufacturer) and the investor assuming the purchase recommendations is unbiased. See Reference 1 for the significant impairment of savings such a conflict imposes on the unsuspecting investor as well as Professor Cummings report for the CSA **A Dissection of Mutual Fund Fees , Flows and performance** http://www.osc.gov.on.ca/documents/en/Securities-Category5/rp_20151022_81-407_dissection-mutual-fund-fees.pdf .

Specialized funds: Even if the mean return and standard deviation are clearly presented and brought to the investor's attention, there are certain investment funds where past statistical information is not relevant to the fund's future risk profile. For example, Target date funds or return of capital (ROC) funds use investment strategies such as shifts in lifecycle asset allocation and cash flow smoothing which render any information gleaned from their historical standard deviation data irrelevant or misleading in the hands of retail investors. Instead of looking at volatility for these types of investments, it is important that consumers understand the fund's strategy and attendant implications. ROC funds have caused investors a lot of harm that a simple risk disclosure might have prevented. Too many people have seen distributions and fund value drop unexpectedly. Ditto for some of the more complex ETF's like Smart Beta or 3x leveraged ETF's.

Risks not captured by the Standard Deviation: There are numerous risks that are typically not captured by the SD indicator – these include securities lending risks, liquidity risks, counterparty risks, operational risks ,risks due to shorting, currency risks and the impact of financial techniques (for example, derivative instruments), unique terms and conditions related to a product (eg. " triggering events" in Target Date Funds) or simply risks that did not manifest themselves during the 10-year period. A prime example is liquidity risk in money market funds which manifested itself during the nonbank ABCP crisis a few years ago. The methodology must provide for prominent disclosure of these material non-SD related risks.

Worst 3 months metric : I recommend this be replaced by worst 12 months over a period of 10 years. If the fund is less than 10 years old, then surrogate data can be used to bridge the gap. All years that were surrogate years would be identified to follow fair disclosure ground rules. This would give an investor a better feel for the potential loss.

Price breakpoints: I recommend they be included in FF's .

Link to KYC -Suitability: Simultaneous with the CSA mandating use of the Proposed Risk Rating Methodology, I recommend that it issue accompanying guidance that makes clear that the risk classifications computed by the Proposed Methodology are but one factor to consider as part of an advisor's Know Your Product and Know Your Client suitability assessment obligations.

As discussed, volatility risk does not capture all of the material risks that should impact a investor's investing decision; I believe it would be incorrect for industry or investors to use the Proposed Methodology's output as a proxy for a proper suitability assessment. For example, if based on a client's NAAF or KYC, the client demonstrates a "medium to high" risk tolerance, this should not automatically mean that any mutual fund which falls in the Proposed Methodology's Medium to High risk band is *de facto* suitable.

This is particularly the case as the mutual fund is likely to make up just one part of a larger portfolio. Whether the overall portfolio risk is compliant with the client's stated risk tolerance must be viewed holistically, in the context of the investor's financial plan. This includes a consideration of the risk represented by the other investments in the client's portfolio and in the context of the client's investment objectives, risk profile, tax considerations and time horizon. For that particular client, a mix of higher risk and lower risk investments may be better suited, rather than simply filtering for those funds that the Proposed Methodology would classify as medium to high risk. Unfortunately, that is a inherent drawback of risk rating a mutual fund.

Performance benchmark: I recommend a performance benchmark be included in FF's. It is important for an investor to determine if the MER associated with active management is worth the money. It should be provided for 10 years using surrogate data if necessary. Armed with this information an investor could compare the cost-risk- return profile of one fund with another. Without it, he/she can't.

DSC disclosure: I recommend that the amount of space for this disclosure be reduced by simplifying the table. This will give a little more page area for more pressing data like the actual risks the fund is exposed to. For Bond and Balanced funds this is especially important given the low interest rates prevailing at this time. As an aside, I note the recent MFDA report on DSC, that seniors are being adversely impacted by this class of fund. It may be time for these types of funds to be prohibited altogether.

Section on " What if I change my mind?": Anything that requires going to see a lawyer probably provides very little value-add to FF's. This section takes up a lot of space that I suspect will be of zero value to the vast majority of readers. I recommend that this section be deleted and the real estate be used for material with more useful information content. I add parenthetically that there should be a standardized right of rescission across Canada: investors should not be disadvantaged simply on the basis of the province or territory in which they reside. It seems industry participants believe that it would be in the best interests of Canadians for the CSA to bring uniformity to investors' rights of rescission and withdrawal. It is my understanding that various industry stakeholders have, for well over a decade, emphasized the pressing need for harmonization of these rights and for clarification of how they are to be interpreted and applied.

ETF's add a lot more complexity – I simply do not have the experience to comment on them except to note that the OSC-IAP had a significant number of Comments on ETF Facts RE http://www.osc.gov.on.ca/documents/en/Securities-Category4-Comments/com_20150806_41-101_iap.pdf

Finally, I hope there is widespread recognition of the need to treat disclosure as part of a broader range of measures, including measures to improve the quality and integrity of financial advice and to increase investor financial literacy.

I sincerely hope this Main Street feedback is useful to the CSA.

You may publicly post this comment letter.

Sincerely,

Sophia Fortier

REFERENCES

1 **The Costs and Benefits of Financial Advice** http://www.hbs.edu/faculty/conferences/2013-household-behavior-risky-asset-mkts/Documents/Costs-and-Benefits-of-Financial-Advice_Foerster-Linnainmaa-Melzer-Previtero.pdf Stephen Foerster, Juhani Linnainmaa, Brian Melzer Alessandro Previtero ,March 8, 2014 Abstract :We assess the value that financial advisors provide to clients using a unique panel dataset on the Canadian financial advisory industry. We find that advisors influence investors' trading choices, but they do not add value through their investment recommendations when judged relative to passive investment benchmarks. The value-weighted client portfolio lags passive benchmarks by more than 2.5% per year net of fees, and even the best performing advisors fail to produce returns that reliably cover their fees. We show that differences in clients' financial knowledge cannot account for the cross-sectional variation in fees, which implies that lack of financial sophistication is not the driving force behind the high fees. Advisors do, however, influence client savings behavior, risky asset holdings, and trading activity, which suggests that
benefits related to financial planning may account for investors' willingness to accept

high fees on investment advice.

SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors
Seeking Truth and Justice

January 7, 2016

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

The Small Investor Protection Association (SIPA www.sipa.ca) was founded in 1998 and is registered in Ontario as a national non-profit organization. Its mission is to aid public awareness and to advocate improved regulation and enforcement. SIPA acts as a voice for small investors.

The opportunity to again comment on the mutual fund risk rating methodology is appreciated. This Consultation is regarded as one of the most important of recent years. As the CSA is no doubt aware, retail mutual fund investors encounter a fair number of problems with mutual fund risk disclosures. Over the years we have reported multiple issues regarding unsuitable investments regarding these disclosures. Most have at their root, excessive exposure to market, fund design and sales practice risk.

SIPA's Advisory Committee has developed this submission drawing upon the five members of the SIPA Advisory Committee as well as other supporters and members. It is hoped that our submission will be received as an indication of SIPA's commitment to work with regulators and others to develop a better investment environment so that the trust investors place in the regulators and the industry will help to spur the leaders to take action to make regulators and industry worthy of that trust.

Preamble

The sentence in FF's "Before you invest in any fund, consider how the fund would work with other investments and your tolerance for risk" may be fine for the experienced DIY investor. For the vast majority of retail fund investors it is an impossible dream. What we have in this consultation is an argument about dessert when we have not even decided where to eat. By the time you get to the simple 2 page snapshot of the fund and the point of sale, the investor should know much more about risk in general and, in general terms, how everything fits together within a portfolio structure. The profile of each transaction is obviously important but, in isolation and without the backing of process and structure, of dubious practical relevance to the individual investor. Thus when attaching importance to POS documentation the primary issues of relevance are the rationale for the portfolio and for the fund within it.

The CSA should not be thinking what a POS should look like unless they are crystal clear on the process underlying the recommendation of the fund itself. This should be clear to all. This is why SIPA believes that simplified disclosure can be helpful at the margin but that the core investor protection issue is the nature of the advisory standard and the processes applied in constructing a cost-effective tailored portfolio.

Introduction and Overview

This consultation is related solely to the administrative details of Fund Facts (FF) risk rating, now extended, despite the critical commentary by the advocacy community, to ETF Facts as well. SIPA however believe that comments must relate to more than just the mechanics of calculating a risk rating. It must include how the rating is positioned, how it is communicated to investors, its legal standing, and its link to KYC and how it fits into the client-representative relationship

The most important issue is the relationship surrounding the disclosure. In a Best interests relationship the disclosure is merely a communication of summary information on fund recommendations with the wider investment planning construct holding the more vital risk and investment planning issues. In a transaction relationship, the FF is quite different and assumes tremendous importance. As long as we have a distribution system reliant on the transaction and remuneration from the transaction, any attempt to improve information flow and education and service outcome is going to be squashed into this small space, the point of sale. We do not believe that the investor after receiving and reading the proposed risk disclosure can reasonably be assumed to have taken ownership of the investment decision.

In any event, this methodology should be restricted to F class funds (and maybe D class) but certainly not to A class funds with an implied service and advice guarantee which is separately charged (via embedded trailers) and paid for by the investor. The guarantee includes a commitment that the investor will be provided advice and that the investment advice is suitable, consistent with the client's KYC/risk profile.

If the CSA insist on using this methodology for A class funds, the warning about representative risk must be strengthened to definitively refer to a conflict-of-interest that exists. It is important to understand that it is the circumstance itself that creates a conflict; there is no such thing as a "potential" conflict. The conflict either exists or it doesn't; whether a conflicted party's conduct changes as a result of the conflict is a separate matter. A large number of independent research reports including the latest one from the CSA, the "Cummings Report", have provided unambiguous evidence of trailer-derived mis-selling that the CSA cannot ignore when exposing investors to Fund Facts.

This Comment letter is based solely on the use of the standard deviation (SD) –based risk rating as it applies to mutual funds. Our comment letter on ETF Facts still is applicable today backed up by even more solid research that the CSA, OSC, OSC-IAP and others have released. A whole added set of issues relates to ETF's. We note that the OSC's own Investor Advisory Panel has provided critical commentary on the issues surrounding ETF Facts. It is surprising that the FF risk rating methodology is now proposed for ETF Facts before a full assessment of Fund Facts investor protection effectiveness has been completed. Some ETFs like reverse and leveraged ETFs do not seem to be suitable to the proposed methodology – they truly have unique structural risks not captured by SD. It is disappointing to see the CSA expanding this controversial methodology to ETF's.

Our documented concerns with the methodology

This is a summary of our concerns regarding the methodology as regards mutual funds:

(a) Volatility is not understood by retail investors; basic literacy is at grade 6 level; financial literacy is also questionable. [Ref According to a May 2011 Ipsos Reid poll Seven in Ten (72%) Canadians are Not Fully Confident Their Math and Money Management Skills Will Help them Plan for a Secure Financial Future http://abclifeliteracy.ca/files/Financial_Literacy_Research-2011.pdf]

(b) The disclosure does not actually disclose the risks of owning the fund. Retail investors will not understand that "Medium" risk can mean a loss of 40% - no rating system should be allowed to mislead and cause harm. Using a word such as "Medium" implies that this is the typical comfort level of an individual investor and conveys very little useful information.

(c) Low volatility mutual funds and ETF's exist that outperform high volatility ones so the CSA risk indicator is not robust The Low Volatility Effect should not be ignored in deciding to use Standard Deviation (SD) as a synthetic risk indicator.

(d) Using SD only and not including specific risks breaches IOSCO disclosure standards Ref http://investorcom.ca/wp-content/uploads/2014/08/IOSCO-releases-its-Principles-of-Point-of-Sale-Disclosure-Final-Report.pdf

(e) SD is really variability of returns not downside risk as commonly understood by retail investors. Volatility will not be understood by retail investors.

(f) To our knowledge, no regulator in the world uses SD as the sole means to disclose risk; the U.S. SEC requires enumeration of the principal risks of the fund/ETF and does not even permit the use of a synthetic risk indicator.

(g) The presented ratings will be based on some mix of actual and proxy figures so the rating is not really the rating of the fund. In fact, it is a misrepresentation. By substituting an index for actual fund performance, the disclosed risk of the fund may be overstated or understated and this problem will be greater the younger a fund is because the younger the fund the more years of reference index performance it will have to use. Furthermore, SD and mean are descriptive statistics of a frequency distribution that MUST be disclosed together to have meaning - FF does not provide this information.

(h) Ten year return data do not exist for most mutual funds/ETF's making the foundation of the methodology shaky as a reliable and trusted disclosure vehicle.

(i) Most common indexes are not Bell shaped; they suffer from kurtosis. The CSA risk indicator which assumes a normal distribution is not standing on a solid foundation.

(j) Many risks are not captured by volatility metric but these are not revealed as is required by ESMA and IOSCO standards. Indeed, the CSA consultation doesn't define risk at all.

FF's itself lists so many disclaimers that it is unclear why the CSA think the methodology is useful. FF's uses words like "typically", "in general " , "may change over time" and "tend to" and closes by saying that the investor will need to consult the funds Simplified Prospectus if he/she wants more information about the risk rating and specific risks that can affect the fund's returns.

Our opposition to the methodology is also backed up by some of the world's top investors based on the ideas that SD is <u>not</u> risk for long-term mutual fund investors. Morningstar UK is forthright about this and demonstrates it by analyzing UK funds results using the SD as the indicator **(Why Volatility is Not an Accurate Measure of Risk);** http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx#sthash.bCVr86mV.dpuf http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx)

Morningstar Canada has also been critical of the proposed CSA methodology. In their March 12, 2014 Comment letter they state "Morningstar believes there are risks associated with utilizing a single measure to evaluate investment risks of a fund or ETF [see opening comments]. However, should the CSA proceed with mandating a methodology for a standard risk assessment, we strongly recommend that it be based on a blend of measures that includes conditional value at risk (CVaR) and a holdings-based approach. We believe that the use of the SD measure as the sole measure of risk does not serve the best interest of the investor." They also fundamentally disagree with the CSA's decision to fix the risk-based breakpoints. SIPA regard Morningstar as a global leader in fund assessment and rating and therefore urge the CSA to consider their thoughtful input.

Our recommendations

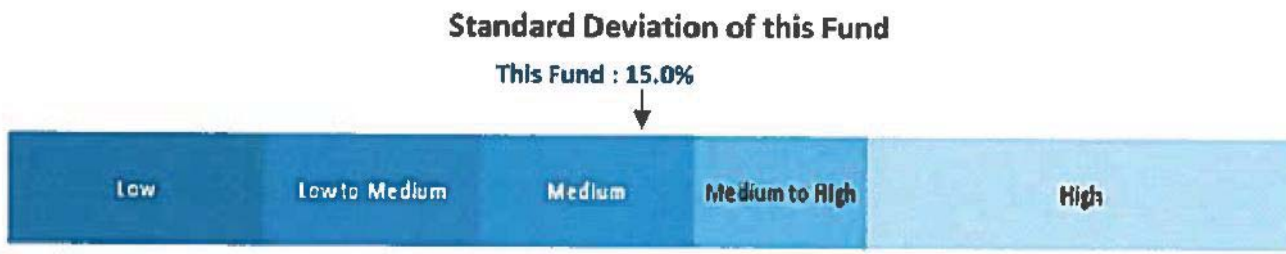
If the CSA is determined to use this methodology, we have some suggestions to improve it:

a. Change the Risk Section heading to "How volatile is it?" to avoid the issue of misrepresentation. A caution note should be added when a fund has used proxy index data to calculate SD so the investor is not deceived by the presentation.
b. All FF's should include a note revealing risks not captured by the volatility calculation as is done in Europe (**ESMA Guide to calculation of volatility** https://www.esma.europa.eu/sites/default/files/library/2015/11/10_673.pdf). Risks that are typically not captured by the indicator can be credit risks, liquidity risks, counterparty risks, operational risks ,risks due to shorting, currency risks and the impact of financial techniques (for example, derivative instruments) or unique terms and conditions like those found in Return of Capital (ROC) funds. Mis-selling of ROC funds has caused investors a lot of grief due to defective disclosure of the risks and product design features.

c. Specialized funds like Life Cycle Funds should use a modified calculation approach per ESMA Guidelines and disclose risks like "triggering events" not captured by the volatility indicator. Since the portfolio composition of a Life Cycle Fund changes substantially over time, it may be the case that not all of the return history of these funds is representative of their current overall risk profile. As a consequence, the ESMA guide requires that the SRRI computation methodology for life cycle funds needs to be modified to reflect the changes over time of the portfolio reference asset allocation as envisaged in their investment policies. The CSA should allow an extra sheet of text if it is necessary for effective disclosure.

d. The risk scale should be retained at six (6) bands to prevent clustering - the goal is to ensure that, for example, a Canadian equity fund would, in the normal course of events , be rated as Medium to high NOT medium (Canadians do not perceive a loss of 35-45% as Medium risk ; seniors definitely don't). The Europeans use 7 numerical risk bands compared to the CSA's proposed 5 and our proposed 6.

e. The risk scale should use numbers NOT words and the SD statistic disclosed



The word descriptors should be replaced with numeric risk levels from 1(low) - 6 (high). The dictionary defines Medium as *something that is the middle size when compared with things that are larger and smaller* which is uninformative and cannot lead to an analysis by the investor. This change will also alleviate another major concern that the words in FF's would be confused with similar or identical words in client KYC file documentation.

The actual SD number should be provided on the scale (as shown above) so at least the sales representative could interpret the meaning of the number to the client. Such a presentation is much more meaningful, quantitative and a good starting point for a discussion on risk-reward between the client and the dealer representative. It makes comparability of fund risk straightforward and provides a clear indication of the magnitude of the difference in risk between two funds. It should also assist in the construction of a suitable portfolio. Several respected industry fund companies are supportive of this as per their previous Comment letters

f. Add a forthright clarifying statement: "Historical data, such as is used in calculating the volatility of the fund may not be a reliable indication of the future risk profile of the fund" rather than the softer "It doesn't tell you how volatile the fund will be in the future".

g. A short explanation must be provided of why the fund is in a certain risk category. Example: The fund belongs to Medium to high risk category. This means that the fund is subject to higher risk in respect of rises and falls in value. It is also important to explain that the indicator is not a measure of any risk of capital loss, but rather a measure of the past increases and decreases in value of the fund.

h. The risk rating must be promptly updated in the event of significant changes in a fund's risk and reward profile, particularly where the variation in risk is related to a change in the fund's objective or investment policy or prior to major marketing efforts In these cases, the categorization should be totally revised.

i. Separately risk rate currency hedged funds. See The Investment Funds Practitioner - November 2013 http://www.osc.gov.on.ca/en/InvestmentFunds_ifunds_20131128_practitioner.htm

j. Since "highly correlated" is not a very precise term, we recommend employing the same index used to measure performance in the MRFP. Actively-managed funds are by definition not highly correlated to their indices: this is their value proposition. Also, there is no definition of "highly correlated" in the Proposal nor is there any guidance as to the meaning of this phrase offered anywhere in Canadian securities law as far as we know. We note that the phrase "highly correlated" is used in the definition of "hedging" in NI 81-102 and some fund managers interpret that as meaning a correlation as low as 50%. This is why we suggest using the manager-selected MRFP performance benchmark or the CIFSC Category data as the proxy. The CIFSC category-based benchmarks should be considered as potential proxies because they are better proxies for the investor experience than market based benchmarks. The latter would ensure greater consistency when comparing funds but we do not know whether the CSA is willing to tie a standard to a voluntary industry group.

k. Move this sentence *"The fund dropped in value in x of the 10 years*" from the performance section of FF's to "How risky is it?" Section.

L Use the best 12 best and worst 12 months instead of 3 months in the performance section. The period covered should be 10 years – if proxy data is required, either the MRFP performance index numbers (or CIFSC counterpart category numbers) should be used. Change the sentence" Consider how much of a loss you could afford to take in a short period of time" to "Consider how you would react to such a loss over the course of a year". Alternatively, use maximum Drawdown over 10-years as has been suggested by numerous commenters. The disclosure of the worst three months performance detracts from a balanced presentation and focuses instead of the worst short-term performance of the fund which is both unbalanced and out of context. This is inconsistent with the long-term perspective that mutual funds are intended to promote and can only have a negative influence on the investor behavior. In fact, the worst 12 months figure or maximum Drawdown could replace the entire section on volatility in the methodology if proxies are acceptable as backfills on missing data to obtain a 10-year metric.

m. Consider changing some the volatility related text to include more functional language e.g. *This means that a fund with a Medium risk of having unexpected average annual return of 5% may expect its returns to vary between -11% and +21% each year under normal circumstances*. We submit that this will be more easily understood by investors, allow for better comparability between funds and relates to the performance disclosure. [In our suggested approach the word Medium would be replaced by a risk level number].

n. Tighten up the sentence" Higher commissions can influence representatives to recommend one investment over another" We suggest "Your representative is in a conflict –of-interest position due to the fact that some products provide a higher paying commission than other products". A much stronger worded warning is warranted in light of the Cummings Report findings. We recommend moving this sentence to the *More about trailing commissions* block of Fund Facts. This is further supported by investor advocate Larry Elford's outstanding work on exposing the use of " advisor" titles to mislead investors as to the true nature of the advisory standard employed (fiduciary vs. suitability) and the OSC's Mystery Shopping experiment where the use of 48 different titles were utilized to confuse investors regarding representative proficiency and qualifications.

Other related recommendations for improving FF's include:

1. Add a section is to inform the unitholder of the objectives of the fund (for example, to provide a steady return on a short-term as well as a long-term basis, long-term capital growth, return in relation to a relevant index, absolute return, etc.), and how the fund management company intends to achieve these objectives .

2. If the fund invests in debt securities, information regarding the issuer and minimum credit rating should be stated. Example: The fund invests in bonds issued by companies. These companies must have a minimum credit rating of BBB on Standard & Poor’s scale.

3. A note should be added that if a front-end load charge or early redemption penalty had been paid , returns would be lower in the "How has this fund performed " section.

4. Include an abbreviated listing of the major risks of the fund in plain language .Even a simple “interest rate risk” statement is better than no disclosure at all. Readers could be referred to the Simplified Prospectus for more details.

5. A CSA Investor User Guide similar to this one used by Capita in Europe is critical.

6. Compress the section on DSC in FF’s to its bare essentials, thereby saving precious FF real estate for more important investor protection disclosures. It is not that DSC disclosure is unimportant but rather that it can be condensed with minimal impact.

7. Add a benchmark so that investors can evaluate the cost-effectiveness of active management. The fact that a Focus Group couldn’t understand benchmarks is not just reason for exclusion. Regulators should provide the information needed to make informed investment decisions. The CSA should include a benchmark section in our recommended User Guide and step up its investor protection education efforts.

8. Consider making FF’s “intelligent “by adding hyperlinks to key documents like the Simplified Prospectus and various CSA brochures and Guides .

In December, 2015 IOSCO published the results of the third annual Risk Outlook Survey. See page 22-24 of the report, in particular, which includes the risks in the area of *investor* protection with a section of Financial Risk Disclosure stating: “An overwhelming majority of respondents reported that inadequate disclosure of financial risks puts investors at risk of buying products or services that are much riskier than individual investors may be comfortable with. As such, there could be a mis-match between the risk appropriate of the investor and the risk embedded in the product.”Risk Outlook Survey: Detailed methodology and results 2015 The CSA should keep these important results in mind as it evaluates the Comment letters to this consultation.

In Summary

The problem that appears to be addressed by regulation is how to keep the transaction wheel oiled, while performing a perfunctory, but flawed, nod to informed investor decisions and investor protection. At a fundamental level we believe that the problem is more to do with the way in which the retail investor is viewed and treated. This is not about advice or responsibility, but about keeping the retail investor in a place where transactions as normal, within the current process, can continue. Note the simple fact that there is no mandated benchmark comparison in the POS Fund Facts document, and no benchmark eliminates the ability to provide effective risk as well as return comparisons.

As we have learned in past studies, moderate investors (i.e., the bulk of investors, most with under $100k in investable assets) seldom look at comparisons more complex than the typical GIC rate when they ask how well their mutual funds are doing. Past studies have shown that the question they ask about an investment is “how safe is it? It is folly to think that an answer based on volatility will be a meaningful answer to their question. The financial crisis has shown the limitations of quantitative measures of risk such as volatility, and volatility derived from past performance has a weak predictive power of future risk.

With our recommendations, we have done our best to transform the FF’s and its risk rating methodology into something investors can use as a first pass review to compare funds and assess appropriateness .

In 2015, "safe" preferred share funds tanked mainly impacted by nasty terms in reset preferred shares. As we enter 2016 we find billions of dollars invested in "safe" Bond funds , all rated LOW risk .Will this rating cause harm to retirees with 50- 70% in Bond funds? Would the CSA support rating bonds by historical SD?

The message that transcends all the various arguments is that risk is more complex than one indicator alone and that standards governing the current retail advisory relationship are a very large part of the risk equation, but one that appears to be ignored by regulators, apart from the two lukewarm consultations on Best interests standards and mutual fund fees.

SIPA is also concerned that pre-sale delivery of FF’s will be deemed to be in full compliance with applicable regulation and that such use offers the fund manager a full defense to any claims of misrepresentation relating to the use of risk and other disclosures. It is essential that the CSA not place small investors in this position.

With over 10 million Canadians holding $ 1.2 trillion in mutual fund savings, it is critical that Fund Facts be fit for its intended purpose especially its risk disclosure. This is particularly important given the sorry state of investor complaint handling and redress in Canada.

All stakeholders need to understand and agree that FF disclosure is but one piece of the investor protection mosaic. Initiatives related to the prohibition of embedded commissions, introduction of Best interests, improved fund sales and marketing practices, enhanced KYC and risk profiling processes , more robust fund governance and enhanced protection of seniors must continue with a sense of urgency .

The CSA must make it clear that it will be responsible for continuing "ownership" of the methodology and will review it at least annually for effectiveness, possible improvement/overhaul and to deal with new innovative fund product developments.

It is hoped this submission is helpful to the CSA in making Fund Facts a more useful document.

If there any questions please do not hesitate to contact SIPA.

Approval is granted for posting this letter on regulator websites.

Stan Buell
President

REFERENCE Documents

Financial Products and Short-Form Disclosure Documents: A Comparative Analysis of Six Jurisdictions by Andrew Godwin, Ian Ramsay: SSRN
Abstract: This article analyses the international trend towards the adoption of short-form disclosure documents for retail financial products through a comparison of six jurisdictions: the European Union, Australia, Hong Kong, Singapore, Canada and New Zealand. For the purposes of the analysis, 'short-form disclosure documents' are defined to mean disclosure documents in respect of which the maximum page length is prescribed, either on a mandatory or recommended basis. The comparative analysis suggests some important findings. These include the strong interrelationship between factors such as purpose, length, liability and language and the extent to which each of these factors, particularly purpose, influences the other factors. Each choice or setting involves certain tradeoffs and achieving a comfortable balance is not an easy task for legislators and regulators. In addition, the findings reveal the challenges that all jurisdictions have encountered in terms of incorporating the key features and risks of complex products into a short-form disclosure document. Finally, there is widespread recognition of the need to treat disclosure as part of a broader range of measures, including measures to improve the quality of financial advice and to increase investor literacy.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2631382

Canadian Financial DIY: Risk and Complexity of Securities and Funds - a Promising Proposal
http://canadianfinancialdiy.blogspot.ca/2016/01/risk-and-complexity-of-securities-and.html

A Risk and Complexity Rating Framework for Investment Products
Abstract: While risk indicators have been developed and widely accepted by the financial industry, hitherto no metric has been developed to measure a product's complexity. In the aftermath of the 2008 global financial crisis, regulators are increasingly concerned about consumer protection. The Lehman Bonds crisis showed that many investors who bought such investments did not have a clear understanding of the product's features. Part of the

reasons is that such products are quite complex and embed features which are difficult to understand. This suggests that if the inherent risk and the complexity of a product's structure are not clearly understood by investors, they would not be in a position to make informed investment decisions. In recognizing that complexity is different from risk, some practitioners have recently attempted to calibrate product complexity. This paper proposes a simple framework to classify the risk and complexity of investment products. We propose to calibrate risk and complexity separately with a list of factors that contribute these attributes. The proposed framework is then used to calibrate a wide variety of investment products to demonstrate its simplicity and usefulness in helping investors make informed investment decisions.
http://skbi.smu.edu.sg/sites/default/files/skbife/A_Risk_and_Complexity_Rating_Framework_for_Investment_Products_July_2014_final.pdf

The Greatest Trick the Devil Ever Pulled ...was convincing investors that volatility and risk were the same thing http://thereformedbroker.com/2015/05/06/the-greatest-trick-the-devil-ever-pulled-2/

Never confuse risk and volatility |*Reuters* http://www.reuters.com/article/us-saft-on-wealth-idUSKBN0H52AL20140910#864ZMketssTXUyD9.97

Is volatility risk?
http://www.schroders.com/en/SysGlobalAssets/digital/insights/pdfs/investmenthorizons-is-volatility-risk-nov2014.pdf

Risk, not volatility is the real enemy
"...You might be interested in Morningstar's series during the past week on their "Risk Management Week Homepage". One paper you might find of particular interest there is "Risk, not volatility, is the real enemy" where Christine Benz discusses some of the flaws of using risk questionnaires in general, especially when they are focused on "investor's response to short-term losses inappropriately confuses risk and volatility. Understanding the difference between the two–and focusing on the former and not the latter–is a key way to make sure your reach your financial goals." She notes that while one often sees the terms risk and volatility used as synonyms, they actually have different meanings. Volatility is a measure of price changes (up or down) over a relatively short period of time (typically "a day, a month or a year"). Whereas the "most intuitive definition of risk, by contrast, is the chance that you won't be able to meet your financial goals and obligations or that you'll have to recalibrate your goals because your investment kitty come up short". So "what might be merely volatile for another person is downright risky for you. That's because there's a real risk that you could have to sell out and realize a loss when your investment is at a low ebb. On the flip side, some of the most volatile investments (namely, stocks) may not be all that risky for you if they help you reach your long-term financial goals. And it's possible to completely avoid volatile investments but come up short in the end because your safe investments only generated small returns." (i.e. volatility might be your friend but risk is your enemy!).... "Source: RetirementAction.com

Understanding tail risk
https://www.pimco.com/resources/education/understanding-tail-risk

The Volatility Anomaly Uncovered |Swedrowe ETF.com

"...Recent academic papers have shown that low-volatility stocks have provided better returns than higher-volatility stocks. What's more, this is a global phenomenon. These findings, however, run counter to economic theory, which predicts that higher expected risk should be compensated with greater expected returns, resulting in the low-volatility anomaly. Of interest is that this finding holds true not only for stocks, but for bonds..."
http://www.etf.com/sections/index-investor-corner/swedroe-volatility-anomaly-uncovered?utm_source=newsletter&utm_medium=email&utm_campaign=dailynewsletter

Product risk disclosure needs improvement
http://www.financialobserver.com.au/articles/product-risk-disclosure-needs-improvement

Investors' perspective on disclosure streamlining
https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/disclosures-white-paper-2014-toolkit-v6.pdf

THE RISK PERCEPTIONS OF INDIVIDUAL INVESTORS
For those investors who systematically perceive risk according to the same risk measure, semi-variance of returns is most popular. Semi-variance is similar to variance, but only negative deviations from the mean or another benchmark are taken into account. Stock investors implicitly choose for semi-variance as a risk measure, while bond investors favor probability of loss.
https://dspace.stir.ac.uk/bitstream/1893/335/1/the-risk-perceptions-of-individual-investors-revision-may30.pdf

The Trouble with Target-Date Funds | Canadian Investment Review
http://www.investmentreview.com/expert-opinion/the-trouble-with-target-date-funds-**6531**

Fees impact Bond fund risk & return « The Wealth Steward
http://thewealthsteward.com/2010/08/fees-impact-bond-risk-return/
"....Two observations. First, the MER reduces the yield-to-maturity by slightly more than the stated level. This is due to the compounding impact of fund fees, which are typically charged daily and paid monthly. Second, fees also nudge duration up because they increase the length of time before the purchase price of the bond is recouped. In other words, fees slightly increase duration risk while also slicing into returns. The result is a double-whammy impact on our risk-return ratio...."

OSC -IAP Report on Risk Profiling Current Practices for Risk Profiling in Canada and Review of Global Best Practices

Volatility Metrics for Mutual Funds https://www.dol.gov/ebsa/pdf/deloitte2009-3.pdf

The Canadian Money State of Mind Risk Survey 2014: Investor Risk, Behaviour & Beliefs The national study conducted for Investor Education Fund (IEF) by The Brondesbury Group, provides a compelling look at how Canadians handle – or *don't* handle – risk, emotion, financial loss and decision-making when it comes to their investments.
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/Investor-Risk-Behaviours-and-Beliefs-2014.aspx#.VoUvwvkrK71

Investor behaviour and beliefs: Advisor relationships and investor decision-making
Research reveals Canadian investors' trust in their financial advisors and confusion about the terms of their relationships.
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/Investor-behaviour-and-beliefs.aspx#.VoU1g6_EirU

Investor knowledge: A study of financial literacy | Our research | GetSmarterAboutMoney.ca
"..*People need to build their knowledge of investment risks and returns.* This is especially true of the prime investing group aged 50-64 and later ages. Seniors need to understand which investments are inconsistent with a capital preservation and income production strategy..."
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/financial-literacy-research.aspx#.VoU12a_EirU

The volatility effect: lower risk without lower return
https://www.robeco.com/en/professionals/insights/quantitative-investing/low-volatility-investing/the-volatility-effect-lower-risk-without-lower-return.jsp

Towards suitable investment decisions? Improving information disclosure for retail investors: A position paper on Key Information Documents for Investment Products: Finance Watch
http://www.finance-watch.org/xcheck.php?filename=ifile/Publications/Reports/Towards-suitable-investment-decisions-PRIPs.pdf

Sample European counterpart to Fund Facts –Key Investor Information Document
Dimensional Fund USD Accumulation shares
http://eu.dimensional.com/media/documents/downloads/uk/pdf/kiid/en/Global_Core_Equity_Fund_USD_Acc_IE00B2PC0153_KIID_EN.pdf

A Review of the Historical Return-Volatility Relationship
http://www.investmentreview.com/files/2015/05/CIR_TDAM-LowVol-Paper-Final-May-2015.pdf

Fund Facts present that "empty ta da" moment! | Depth Dynamics
http://blog.moneymanagedproperly.com/?p=716 ,,,".

Point of Sale Disclosure and Regulatory Failure in Canada
Time to reread Andrew Teasdale's classic now that regulators are close to decisions on Best interests, assessment of advice and registration of "advisors". He wrote a detailed report into Canadian regulation and the new Point of Sale documentation with international comparisons in September of 2010. Point of Sale Disclosure and Regulatory Failure in Canada

Fund Facts: The answer to every Advisor's Prayer?

"..What I didn't get out of the document is any sense of how this fund compared with its peers or against the benchmark (the index). It describes the fund as "low to medium risk" and suggests it would be suitable for those who "seek income from your investment, and you are comfortable with the risks associated with equity investments." Well, that's pretty much the kind of meaningless statement you'll find in the much-aligned prospectuses.." http://business.financialpost.com/uncategorized/fund-facts-the-answer-to-every-advisors-prayer

A Survey of Securities Market Risk Trends 2015 Methodology and detailed results
https://www.iosco.org/library/pubdocs/pdf/IOSCOPD516.pdf

Andrew Teasdale (CFA) blog on Fund Facts Risk Classification Methodology
http://blog.moneymanagedproperly.com/?p=3409

Don't get screwed by your financial advisor
Screwed! Too many investors are being poorly served by advisors. Here's how to avoid becoming the next victim
http://www.moneysense.ca/planning/dont-get-screwed-by-your-financial-advisor/

By email Jan . 4, 2016

David Fieldstone Submission

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

For all of those in interest and concerned:

I appreciate the opportunity to comment on the fund risk rating methodology. Judging from the letters already posted. it's obviously a controversial methodology.

I think for most people saving for retirement, risk is the chance of losing money - the bouncing around of monthly returns for someone investing over 10, 15 or 20 years is a useless statistic further made useless with ill- defined words with no numerical or other context . In fact historical monthly volatility of returns really does not translate to long term risk in my mind at all. Not only is it useless in portfolio construction but it is actually misleading and harmful. If the CSA is going to authorize this methodology at least the Standard deviation value should be cited in numerical terms. The “adviser” can then meaningfully interpret this for the client.

Also, it seems to me to be a deception, when a Fund can advertise a Low to Medium risk rating when half the data or more are derived from an index selected by the fund manager rather than actual data. Fund Facts (FF) should prominently warn the investor that this is a rating only partially made up of real fund numbers over the 10 years. I would much rather see the worst 12 months return over the 10 years even if it was all an index closely correlated with the fund. That would be useful. And by the way, why not provide an index benchmark, so an investor could compare the actively-managed fund's performance to a passive index?

The " How risky is it? Section in Fund Facts deals with volatility. No matter how many times I read it it comes across as gibberish. What I want to know is what exactly are the risks in the fund? How much can I lose?

The volatility rating is based as I understand it, on the well behaved Normal distribution. Skewness and Kurtosis are important because few real world investment returns are normally distributed as assumed by the CSA. A rating based on the calculated standard deviation is therefore quite possibly inaccurate. An investment's skewness and kurtosis measure how its distribution differs from a normal distribution and therefore provide an indication of the reliability of predictions based on the standard deviation. As Figure 6 in this article *Assessing Skewness and Kurtosis in the Return Distribution* highlights, two investments with very different distribution profiles can have the same mean and standard deviation. Therefore, it is useful to consider other methods for predicting returns. This is why I take the proposed risk rating methodology with a grain of salt. https://www.evestment.com/resources/investment-statistics-guide/assessing-skewness-and-kurtosis-in-the-return-distribution/

From the perspective of a retail investor the word **Medium** risk is misleading. If you look at a random selection of Canadian and US Equity Funds, the losses in 2008 ranged from 32-48 %, yet they are rated Medium risk. The word **Medium** risk is deceiving and could easily destroy a RRIF account. Why not use a number scale or colour code? I note that Europe uses 7 bands; the original CSA proposal used -6-. So why is 5 now an optimum number, since it means there will be excessive clustering around Medium risk?
Bond mutual funds make up over 40% of my portfolio - virtually all are rated LOW risk. What happens if interest rates rise? And then there are the “junk bonds”.

The other issue I have with the risk rating is the fact that nearly half the cost of buying an equity mutual pays for “advice”. Adviser risk is a risk at least as big as any risks from the person managing the fund. There should be a clear bold warning in Fund Facts that the “adviser” or whatever title they choose for themselves, is in a conflict- of- interest.

There is legion of research clearly showing that this conflict actually causes harm to the investor. No beating around the bush in the wording. This would encourage investors to ask more questions, do more research, and/or find another adviser. The United States SEC mandated disclosure in the Summary Prospectus is patently more forthright than the disclosure in FF's: **"Payments to Broker-Dealers and Other Financial Intermediaries. If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."**

Given the nature of FF's, I think an Investor Users Guide is critically needed to obtain the potential benefits. It could also explain the ideas behind the fund risk rating in simple language, and show investors how to use each data block in FF's for better investment decision making. It would furthermore make it clear that the fund rating has limitations and encourage investors to ask advisers more questions about fees, risks and returns.

I do not find the section -How risky is it? - of much value, and I would never use it in my decision making. The G&M, Morningstar, and Fund-library offer better detail and insight – online - ncluding the important ability to compare against a benchmark.

Because it deceives - I cannot support this methodology no matter how much the rules surrounding it are tuned up as a result of this consultation. It is a matter of basing - on unsubstantiated statistical assumptions, surrogate numbers, undefined word(s) standing in for standard deviation which itself is not understood by retail investors , goes against the wisdom of the world's greatest investors, doesn't actually identify the major risks of investing in the fund and in the end provides a misleading rating.

Risk is a huge concern for seniors/retirees. The CSA can and should do much better in disclosing it. Just look at the troubling OBSI complaint statistics. You need to think like an investor not a lawyer or mathematician when choosing a risk disclosure approach for unsophisticated investors .

As a lawyer, I am also concerned that pre-sale delivery of FF's will be deemed to be in full compliance with applicable securities law and that such use offers the dealer/fund manager a full defence to any claims of misrepresentation relating to the serial use of misleading risk and other disclosures. It is essential that the CSA not place investors in this position in the way it frames FF's as a decision tool.

Fund Facts is a step in the right direction and a 4 page document is more likely to be read by retail investors than the "Simplified" Prospectus. I sincerely hope that both regulators and the industry will view Fund Facts as a critical disclosure document affecting the life savings of over 10 Million Canadians . In particular, Fund Facts needs to improve its risk disclosure and suitability guidance . The guidance should be aimed squarely at ordinary Canadian investors. The fact that SD is in common use and easy to calculate is not relevant to investor protection if it's unfit for use.

I hope this feedback from Main Street is useful to you.

I grant permission for public posting of this Comment letter.

Sincerely,

David M. Fieldstone, BA LLB
(Retired barrister & solicitor)
Toronto, Ontario, Canada

Hi,
I sure wish you would incorporate a more complete risk rating methodology than the dangerously simplistic reliance on price volatility.

Professional practicians know better and so should you. In case you have not seen it, here is the best explanation of the many facets of investing I have ever seen - Howard Marks of Oaktree Capital's ***Risk Revisited Again***

Regards,
Jean Lespérance
http://howtoinvestonline.blogspot.co.uk/
http://canadianfinancialdiy.blogspot.co.uk/

By email December 29th. 2015

PETER WHITEHOUSE Submission -

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

I appreciate the opportunity to comment on the fund risk rating methodology.
As a retired senior I have had more than my fair share of problems with mutual fund disclosures over the years.

In “ Why Bogle and Buffett tell investors to ignore market noise ” John Bogle, one of the giants of the mutual fund industry says "Don't pay a lot of attention to the volatility in the market place. All these noises and jumping up and down along the way are really just emotions that confuse you. The question isn't "Will my investments go up or down?" — because of course they will. The question one should ask is, "Will the fact that investments go up and own bother me enough to do something dumb? " The article is very clear – VOLATILITY is NOT Risk.

Bogle's words resonate with me. I think for most people saving for retirement ,risk is the chance of losing money - the bouncing around of monthly returns for someone investing over 10, 15 or 20 years is a useless statistic further made useless with sugar coated words with no numerical or other context .Not only is it useless in portfolio construction but it is actually misleading and harmful.

In a June 2013 US News and World Report article Risk and Volatility aren't the same we find the following statement : "Risk and volatility are not interchangeable, and trying to minimize volatility can actually hurt returns over time. The financial services industry is rife with advisers, compliance departments and research departments who embrace constructing portfolios with a serious allocation to bonds because they will lower volatility. Not only is it well proven that stocks outperform bonds over the long term, but at today's interest rates, the interest payments on bonds are having a hard time even outpacing inflation . So in the interest of reducing short-term volatility, portfolios are being constructed with investments that increase the probability of actually impeding long-term growth...." Yet FF says " One way to gauge risk is to look at how much a fund's returns change over time. This is called "volatility"..." If that isn't misleading disclosure I don't know what is.

It's not just the mischaracterization of volatility as risk that bothers me. I'm not a mathematician but it seems to me to be a deception when a Fund can advertise a Low to Medium risk rating when say 108 months of data are derived from an index selected by the fund rather than actual data. FF does not even warn the investor that this is a back-tested rating. It's like building a house of Jello on a foundation of quicksand!Even the prescribed method of converting the standard deviation of monthly returns isn't quite right. In What's wrong with multiplying by the square root of 12?
Morningstar explain the biases in the formula. I leave it to others to determine if this formula is accurate enough for its intended purpose.

The " How risky is it? Section in Fund Facts deals with volatility. No matter how many times I read it it comes across as baffle-gab. We all know stocks go up and down but what I want to know is what exactly are the risks in the fund? In fact monthly volatility over the long run really does not translate to risk in my mind at all. Some mutual funds are actually offering to sell me low volatility funds that offer superior returns so does high volatility really mean higher risk? (BMO news release on low volatility stocks https://www.bmo.com/gam/pdf/press-release/Press-Release-White-Paper-Low-Volatility.pdf)

From the perspective of a retail the word **Medium** risk is misleading. Consider the Dynamic Power American Growth Fund A Series . The Fund Facts for this fund's A-series units fund for example rates risk as Medium risk; according to its Fund Facts performance it lost **44.1%** in 2008. Too many people may use this rating without correlating it with the fund's historical returns. For new funds there may not be a historical record to view and people will be deceived by the word “Medium”. The word **Medium** risk means nothing and does not help an investor deciding to accept a salesperson's recommendations. I can almost see a fund dealer defending against a client complaint by citing this risk rating. That would be the ultimate insult to the retail investor.

Consider again the Dynamic Power American Growth Fund A Series . The Fund Facts for this fund’s A-series units says that it’s suitable for investors • seeking the capital growth potential of investments in equities of businesses based in the United States and • able to accept some variability of returns and are investing for the long term. The Fund Facts for the very same fund’s T-series units includes the same description as above but adds that it’s also suitable for investors “seeking stable monthly distributions”. These are not two similar funds but rather two series of the same fund – i.e. the identical legal entity. Accordingly, suitability recommendations should also be identical. Mandating regular distributions – as is done with T series funds – does not change suitability.

Using the Dynamic Fund once more as an example we find that it's T series is also rated Medium risk. The ‘T’ in T series is short for ‘Tax’– so called because of its perceived tax advantage. The appeal of a T series fund lies in its highly marketed relatively high and level cash distributions. The tax moniker is given because the majority of the monthly cash payout is not taxable when received because it’s classified as “return of capital” for tax purposes. In reality if the fund distributes out more than it earns , the value will fall and the investor will be shocked and confused . Many people are mis-sold these funds and I think FF's should tip them off about this but this rating system isn't geared up to do that because it's rated solely on volatility. In an article entitled **T SERIES FUNDS: THE TAX EFFICIENCY MYTH AND STRUCTURAL RISK** Dan Hallett noted “ We have a record of identifying T-series funds that are at risk of cutting distributions. Most notable was our December 2001 prediction that IA Clarington Canadian Income-T8 would be forced to cut its distribution. We were proven right. When so many investors use the cash for living expenses, advisors must set the right expectations at the outset. Doing so will make your clients much happier than if you have to explain to them why the cash they’ve been spending cannot continue.” Amen. Ditto for FF's.

As to Bond funds which make up about 50% of my portfolio, virtually all are rated LOW risk . The Dynamic Canadian Bond Fund FF's for example shows a LOW risk rating after a decade of postive returns in a record low interest rate environment. Should interest rates rise, it seems to me this fund will suffer badly, impairing my RRIF account. A robust disclosure on risk shouldn't let that happen. And by the way , up to 50% of assets can be invested in foreign bonds, adding currency and other risks to the mix. So to really avoid the loss to my retirement savings I'm back to having to read the prospectus again. Makes no sense.

The other issue I have with the risk rating is the fact that nearly half the cost of buying a equity mutual fund has nothing to do with the fund. It is for advice from a salesperson paid by the fund company. From bitter experience I can tell you this is a risk at least as big as any risks from the fellow managing the fund. There should be a clear bold warning in Fund Facts that the salesperson is in a conflict- of- interest. No mincing of words. This would encourage investors to ask more questions and/ or do more research.

Finally, the risk rating methodology is fundamentally defective because it doesn't even try to match risk and return. How can a person decide on a word acting as a proxy for risk (but no actual standard deviation numeric is provided) with a return that is also not provided? Isn't it true that the idealized Bell curve needs two metrics to describe it not just one and that's assuming the Bell curve is a good fit with the actual pattern of returns we see in real life markets?

Given the data density and fogginess of FF's, I think a Users Guide is critically needed. Suggested Key elements :

a) An explanation of each section and how to use it for decision making
b) A plain language explanation of volatility
c) A concise paragraph on each of the five fund ratings and their meaning
d) A short discussion on conflicts of interest vs unbiased advice
e) Why fees are important and how the DSC can cause investors to hold on to losers
f) Some gauge as to what long-term investing means
g) A short glossary of key terms
h) References/ links to other CSA investor educational materials

I do not find the section " How risky is it? of any value and I would never use it in my decision making. Because it deceives , I cannot support this methodology no matter how much the administrivia surrounding it are tuned up as a result of this consultation. It is based on unsubstantiated statistical assumptions, surrogate numbers , undefined word(s) standing in for standard deviation which itself is not understood by retail investors , goes against the wisdom of the world's greatest investors and in the end still doesn't actually identify the risks of investing in the fund.

If I was the CSA I would get the opinion of CFA's , CFP's , investor advocates , SIPA , Kenmar and FAIR Canada before going further with this risk rating scheme. It's a ticking time bomb.

Fund Facts is a step in the right direction and it's more likely to be read by retail investors. But there is a lot of work to do, so I hope that both regulators and the industry will view Fund Facts as a document that is a work in progress . In particular,Fund Facts needs to improve its risk disclosure and suitability guidance-guidance not aimed at fund managers but at better informing ordinary Canadian investors.

I grant permission for public posting of this Comment letter.

Peter Whitehouse

Via email transmission December 28, 2015

Comment letter by Mr. Arthur Ross

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

I appreciate the opportunity to again comment on the mutual fund risk rating methodology. As a mutual fund investor I have had more than my fair share of problems with mutual fund risk disclosures over the years. When I last commented on this topic my letter was based on actual experiences and backed up by solid references. I am therefore very disappointed to see the CSA basically going along with industry proposals and ignoring my input.

In my letter I expressed concerns about the standard deviation (SD) as a measure of risk, the inability of the average fund investor to comprehend the disclosure and make use of it, ICI research supporting narrative disclosure of risk , advisor risk etc. My opposition to this methodology remains even stronger today after a year of struggling with the risk disclosure portion of Fund Facts (FF).

Of course my opposition to the methodology is also backed up by some of the world's top investors based on the ideas that SD is not risk for the long-term investor and that the Gaussian distribution is not a good approximation of real world return data. Morningstar UK is forthright about this and demonstrates it by analyzing UK funds results using the SD as the indicator (Reference 2). A sparsity of data to support the 10-year SD averaging period adds to the criticism of the CSA methodology.

In an article **"Does volatility equal risk?** Edgepoint Wealth , a prominent Toronto-based Asset Manager said this " The formula for standard deviation treats all volatility the same. It tells you how much results have deviated from their historical average, whether above or below it. Thus, an investment with nothing but positive returns can nevertheless have high volatility if those results have varied from slightly positive to massively so. Put simply, volatility measures how a stock trades and not necessarily how much business risk it holds."
http://www.edgepointwealth.com/en/Resources/EdgePointAcademy/Does-volatility-equal-risk

A whole added set of issues relates to ETF's . I note that the OSC's own Investor Advisory Panel has provided critical commentary on the issues surrounding ETF Facts. Some ETF's like reverse and leveraged ETF's do not seem to me to be suitable to the proposed methodology . My comments relate only to mutual funds.

Here are some suggestions to improve the selected methodology :

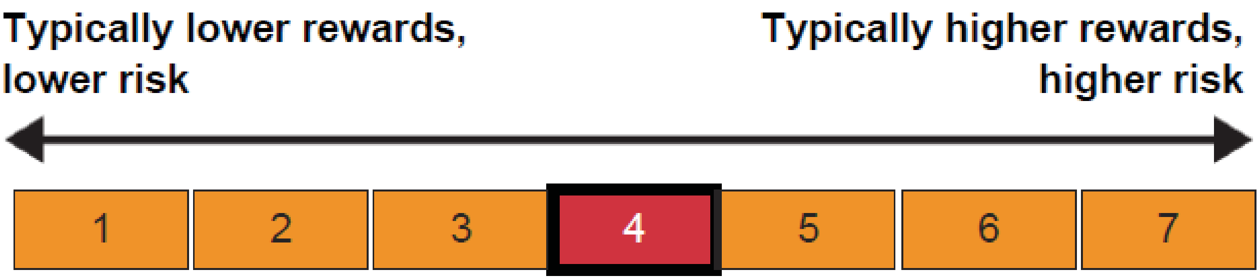
a. A note should be added when a fund has used proxy index data to calculate SD so investor is made aware of what he is looking at. Change the Section heading to : " How volatile is it?"

b . All funds should include a note highlighting risks not captured by the volatility calculation as is done in Europe. Risks that are typically not captured by the indicator can be credit risks, liquidity risks, counterparty risks, operational risks ,risks due to shorting, currency risks and the impact of financial techniques (for example, derivative instruments) or unique terms like those found in Return of Capital funds.

c. Specialized funds like Life Cycle Funds should use a modified calculation approach per ESMA Guidelines (Reference 1) and /or disclose risks not represented by the volatility calculation . Since the portfolio composition of a Life Cycle Fund changes substantially over time, it may be the case that not all of the return history of these funds is representative of their current overall risk profile. As a consequence, the ESMA requires that the SRRI computation methodology for life cycle funds needs to be modified to reflect the changes over time of the portfolio reference asset allocation as envisaged in their investment policies. The CSA should do the same and allow an extra sheet of text if necessary.

d. The scale should be retained at six (6) buckets to prevent clustering - the goal is to ensure that, for example, a Canadian equity fund would, in the normal course of events , be rated as Medium to high NOT medium (Canadians do not perceive a loss of 35-45% as Medium risk).

e. The scale should use numbers NOT words. Viz. Sample from Europe



The dictionary defines Medium as *something that is the middle size when compared with things that are larger and smaller* which isn't particularly informative. This will also alleviate one concern that the words in FF would be confused with KYC documentation: The Europeans use 7 buckets compared to CSA's proposed 5.

f. Add a clarifying statement that historical data, such as is used in calculating the SD, may not be a reliable indication of the future risk profile of the fund rather than “ It doesn't tell you how volatile the fund will be in the future”.

g. Among other things, an explanation must be provided of why the fund is in a certain category. Example: The fund belongs to Medium to high risk category. This means that the fund is subject to higher risk in respect of rises and falls in value. It is also important to explain that the indicator is not a measure of any risk of capital loss, but rather a measure of the past increases and decreases in value of the fund.

h. The risk rating must be promptly updated in the event of significant changes in a fund’s risk and reward profile, particularly where the variation in risk is related to a change in the fund's objective or investment policy or prior to major marketing efforts In these cases, the categorisation should be totally revised.

i. Separately risk rate currency hedged funds. See The Investment Funds Practitioner - November 2013
http://www.osc.gov.on.ca/en/InvestmentFunds_ifunds_20131128_practitioner.htm

Other related ideas for improving FF's :

1. Add a section is to inform the unit holder of the objectives of the fund (for example, to provide a steady return on a short-term as well as a long-term basis, long-term capital growth, return in relation to a relevant index, absolute return, etc.), and how the fund management company intends to achieve these objectives .

2. Tighten up the sentence" Higher commissions can influence representatives to recommend one investment over another" I suggest " Your representative is in a conflict-of- interest which can influence the investments recommended to you". A much stronger wording is warranted in light of the Cummings Report findings.

3.If the fund invests in debt securities, information regarding the issuer and minimum credit rating should be stated. Example: The fund invests in bonds issued by companies. These companies must have a minimum credit rating of BBB on Standard & Poor's scale.

4. Provide the actual SD number on the scale so at least the sales representative could interpret the meaning of the number in plain language.

5. Instead of using index data to backfill missing monthly retirns data, consider using actual data from the relevant CIFSC fund category.

6. Include an abbreviated listing of the major risks of the fund in plain language .Even a simple " interest rate risk" statement is better than no disclosure at all. Readers could be referred to the CSA's Guide to Mutual Funds for more details on risks.

7. A CSA Investor User Guide similar to this one used by Capita in Europe is critical. A good way to describe the 5 risk levels is shown below:

Table 3. Category Descriptions of Vanguard Risk Levels

Vanguard funds can be categorized in risk levels from 1 to 5. Knowing the risk level you're comfortable with, and the length of time you expect to invest, can help you select an appropriate fund for your investing needs.	
Conservative funds—Risk level 1	Vanguard funds are classified as conservative if their share prices are expected to remain stable or to fluctuate only slightly. Such funds may be appropriate for the short-term reserves portion of a long-term investment portfolio, or for investors with short-term investment horizons (three years or less).
Conservative to moderate funds—Risk level 2	Vanguard funds classified as conservative to moderate are subject to low-to-moderate fluctuations in share prices. In general, such funds may be appropriate for investors with medium-term investment horizons (four to ten years).
Moderate funds—Risk level 3	Vanguard funds classified as moderate are subject to a moderate degree of fluctuation in share prices. In general, such funds may be appropriate for investors who have a relatively long investment horizon (more than five years).
Moderate to aggressive funds—Risk level 4	Vanguard funds of this type are broadly diversified but are subject to wide fluctuations in share price because they hold virtually all of their assets in common stocks. These funds may be appropriate for investors who have a long-term investment horizon (ten years or longer).
Aggressive funds—Risk level 5	Vanguard funds classified as aggressive are subject to extremely wide fluctuations in share price. These funds may be appropriate for investors who have a long-term investment horizon (ten years or longer). The unusually high volatility associated with these funds may stem from a number of strategies.
Source: The Vanguard Group, Inc.	

Volatility Metrics for Mutual Funds https://www.dol.gov/ebsa/pdf/deloitte2009-3.pdf

It should be made clear that the CSA will be responsible for continuing " ownership" of the methodology and will review it at least annually for effectiveness , possible improvement and to deal with new innovative fund product developments.

In 2015, "safe" preferred share funds tanked mainly impacted by nasty terms in reset preferred shares. As we enter 2016 we find billions of dollars invested in "safe" Bond funds , all rated LOW risk - is this rating a road to ruin for retirees with 50- 70% in these funds?

I fear for all of the small retail investors who will look at the FF risk ratings in making decisions about where to invest their RRSPs this year. They are, without a doubt, like deer in headlights about to be hit by a car. Perhaps they will be lucky. Perhaps not. Is this investor protection? [ref According to a May 2011 Ipsos Reid poll Seven in Ten (72%) Canadians Not Fully Confident Their Math and Money Management Skills Will Help them Plan for a Secure Financial Future
http://abclifeliteracy.ca/files/Financial_Literacy_Research-2011.pdf]

I hope this submission is useful to the CSA and this time will be considered in its decision making.

Approvel is granted for posting this letter on regulator websites.

Arthur Ross

REFERENCES

1. ESMA Guide to calculation of volatility
https://www.esma.europa.eu/sites/default/files/library/2015/11/10_673.pdf

2. **Why Volatility is Not an Accurate Measure of Risk** : Morningstar UK
“By focusing on absolute levels of volatility as the key measure of risk, investors are prevented from buying risk assets when prices are low as these typically corresponded to periods of high volatility. Equally, portfolio managers are encouraged to buy risk assets when prices are high. This buy high, sell low strategy is unlikely to be in the clients’ best interests.

The practical problems with this approach are especially evident when using absolute levels of volatility to match funds to client risk profiles. Morningstar has recently conducted research that shows that the volatility of a conventional multi-asset portfolio varies widely through the market cycle. We created a series of multi asset portfolios and tracked their volatility using the approach stipulated for the calculation of a fund’s synthetic risk return indicator (SRRI) that is included in key information documents (KIID). The volatility of these portfolios varied significantly over time. For example, the volatility of a moderate risk portfolio comprised of recognized benchmark indices varied by 5.3% over the last 9.5 years. This volatility range is greater than the SRRI band (four) used to classify the fund.

This means that a portfolio positioned in the middle of an SRRI band at the beginning of the period and rebalanced regularly would breach both the upper and lower boundaries

of that band over the period. In other words, without changing the allocation, the portfolio fund would be both too risky and not risky enough for the same client over the period. **A risk mapping process that produces such widely varying results for a stable portfolio is clearly not fit for purpose.**”
http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx#sthash.bCVr86mV.dpuf
http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx

3. AMF (France) guide for Key Investor Information Document (KIID)
http://www.amf-france.org/technique/multimedia?docId=573eed3a-0b6f-455a-a558-bb1bd8f7ba0d

4. **The challenge of providing clear product disclosure:** Blackrock
https://www.blackrock.com/corporate/en-ca/literature/whitepaper/challenge-of-providing-clear-product-disclosure-april-2011.pdf

5. **. Key Investor Information Document (Sweden)**
http://www.fondbolagen.se/PageFiles/6246/UK%20Manual%20Faktablad%20140317-eng.pdf

6.**STANDARD DEVIATION AND PORTFOLIO RISK JARGON AND PRACTICE**
“... When we teach jargon-related concepts, we need to simultaneously teach students how to describe these concepts to non-specialists. When we use the word "risk" to describe the attribute of a portfolio that is measured by variability, we need to explain the shortcomings of this interpretation. In particular, we need to discuss in finance classes what "financial risk" might mean to various lay-persons. I would suggest that this is not merely "service course" material - it is needed by the experts too,”
http://people.stat.sfu.ca/~weldon/papers/29.sdrisk.pdf Published by Simon Fraser University

7. CARP helps mutual fund dealers understand what the average older investor expects : CARP Canada http://www.carp.ca/2013/10/18/carp-help-mutual-fund-dealers-understand-what-the-average-olderinvestor-looks-like/

8. **Comment letter from Mr. W.Schalle**
https://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20140203_81-324_schallew.pdf

9. **Volatility vs. Tail Risk: Which One is Compensated in Equity Funds?** by James X. Xiong, Thomas Idzorek, Roger G. Ibbotson :: SSRN James X. Xiong Ibbotson Associates, a Morningstar company; Thomas Idzorek Ibbotson Associates - A Morningstar and Company and Roger G. Ibbotson Yale School of Management; Zebra Capital Management, LLC (May 30, 2013) Abstract: Research that has led to what is known as the “low volatility anomaly” in cross-sectional stocks from a similar universe indicates that volatility is not compensated with a “volatility” premium. We find evidence of a risk premium, but it depends on the definition or measure of risk. “Tail risk” measures the probability of having significant losses and should be what investors care about the most.

We investigated several risk measures, including volatility and tail risk, and found that volatility is not compensated but tail risk is compensated with higher expected return in both U.S. and non-U.S. equity funds. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2274295

10. **What Behavioral Finance Teaches on How to Discuss Risk With Clients**
http://www.thinkadvisor.com/2011/07/18/what-behavioral-finance-teaches-on-how-to-discuss

11. **Dow Jones 100 Year Historical Chart** | MacroTrends
http://www.macrotrends.net/1319/dow-jones-100-year-historical-chart

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https://www.cass.city.ac.uk/__data/assets/pdf_file/0017/32525/risk-rating-comp.pdf

Kenmar Associates
Investor Education and Protection

Via email

December 23, 2015

Kenmar Associates Comment Letter

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Kenmar is pleased to comment on the latest proposals for the risk rating disclosure of mutual funds and ETF's. We restrict our comments to mutual funds as ETF issues are far more complex and our resources are limited. Our last ETF Facts Comment letter can be found at https://www.lautorite.qc.ca/files/pdf/consultations/valeurs-mobilieres/sept-2015/kenmar.pdf It raised a significant number of serious investor protection concerns including risk disclosure. One BIG issue is that ETF Facts will be delivered after the sale which means there is in effect no disclosure allowing the investor to make an informed investment decision.

Kenmar appreciates the CSA's effort in trying to integrate 13 securities regulators, multiple industry participants and investors/ investor advocates. We acknowledge all the time and effort it took to get agreement to deliver FF's prior to sale. Risk disclosure is a complex topic but we must all remember the main purpose- giving investors dependable information to make an informed decision related to their objectives, time horizon and risk profile. We agree that if a risk rating system is to be used that it should be standardized and under CSA cognizance.

A great deal of effort was put into our previous 2013 submission to the CSA (see Reference 1). We talked to dozens of investors, regulators , advisors, lawyers , investor advocates and uncovered a wealth of independent academic research on mutual fund risk disclosure. Typically, the main risks of a Canadian mutual fund are market risks of securities in the portfolio, product structure/terms risks, PM risks, and advisor risk (embedded commissions for distribution /advice often accounts for about 50% of product cost which is bundled into fund pricing). The proposed risk rating methodology does not effectively deal with these risks and as such fails to meet its intended purpose- to answer the question " How risky is it ?" where " risky " is defined as *attended with risk or danger : hazardous* according to the Merriam-Webster dictionary

We believe our submission was an informed one. We are therefore more than a little surprised and disappointed that this input has had virtually no impact on the CSA's decision to retain the SD-based risk rating methodology and use it as a proxy for fund risk disclosure for unsophisticated retail mutual fund investors. In this Comment letter we restate our main concerns and buttress our position with further critical research and information that has come to light since then. It is our hope that this level of additional analysis will cause the CSA to re-assess its decision.

We realize this consultation has been framed so as to be limited to the fund risk rating classification methodology mechanics but we , with all due respect , feel it cannot and should not be assessed in isolation from the other variables that will impact its practical effectiveness (or otherwise). Accordingly, we raise issues that deal with unintended consequences, critical gaps,the definition of "risky", examples of ratings breakdowns and the linkage to behavioural finance. To the extent FF is to act as a tool for better investor investment decisions, it is to that extent we feel these other matters must be dealt with on a holistic basis before even commenting on the mechanics of the methodology/ SD risk rating classification system. An unduly narrow viewpoint could cause harm and that should never occur as a result of a regulatory disclosure. That is our perspective on the meaning of investor protection and how we are responding.

Mutual funds must currently include in the so -called Simplified prospectuses a detailed narrative disclosure describing the major risk factors associated with a fund. Fund managers go into such detail for a number of reasons, including the desire to respond to comments on prospectuses by Commission staff and efforts by fund counsel to minimize disclosure liability. As noted by securities regulators, behavioural economists and investor advocates, such detailed legalistic disclosure can deter the reading of the Prospectus and can obscure a fund's overall risks.

Hence the need for a Fund Facts and our support for the document. Kenmar believe that it is important that FF disclosure should focus more on a fund's broad investment objectives, its strategies to reach those objectives, and the fund's principal risks accompanying those strategies. Using a holistic approach to risk disclosure would greatly enhance investor understanding, particularly when reinforced by MRFP/discussions of the relevant market conditions and general investment strategies and techniques pursued by the fund that materially affected performance.

We are strongly opposed to a risk rating that doesn't actually annunciate the risks of investing in the fund and thereby misleads investors. With about $1.2 trillion invested in mutual funds, this is a HUGE issue since poor risk disclosure is the #1 root cause for unsuitable investments/complaints . Kenmar has put defective risk disclosure on its TOP 5 investor protection list for the past 5 years. IOSCO have also expressed concerns about risk disclosure in its latest report , *A Survey of Securities Market Risk Trends 2015 Methodology and detailed results* (Reference 10).

Mutual funds are a key component of retirement income security for millions of Canadians, so robust risk disclosure is critical, especially in an environment where advisors do not have an obligation to act in the client's Best interests.

In the current consultation we find that the CSA is employing the Standard Deviation (SD) using the five-Category approach based on fund industry lobbyist IFIC's methodology except that a 10-year SD period is being used. The CSA has also changed the standard deviation ranges proposed in the 2013 Proposal, which now make them consistent with the SD ranges in the IFIC Methodology. As requested by industry participants,the CSA has removed the list of index acceptability criteria, but has retained the list of reference index principles and amended it (Assumed to be Total return versions if that is the basis for which performance data is provided).Per industry feedback , the investment risk level must now be determined upon the filing of a Fund Facts or ETF Facts and, in any case, at least annually rather than monthly as last proposed. It should be noted that an index is a costless and friction-less benchmark indicator. Heeding industry recommendations, the CSA has removed the requirement to maintain records for a ten-year period to determine the investment risk rating of a mutual fund , reducing it to 7 years.

On the other hand, the proposed risk rating disclosure has not addressed most of the issues we and others raised in the earlier consultation . We continue to argue that the SD approach is not an actual disclosure of the risks of the fund and its word descriptors are misleading retail investors . Our approach here is to systematically discredit the chosen approach even while offering commentary on its mechanics.

It is instructive to see what an actual retail investor, a Mr. S. Gourley, said in his submission : " *Finance academics usually identify risk as the volatility associated with the prices and/or returns of investments. However, I believe this approach is much too complex to be used by a retail investor. Unitholders think of risk as the prospect of an undesirable outcome, such as a financial loss or not meeting a life goal investment objective. They want to know " How much can I lose?". The standard deviation (SD) derived disclosure requires some knowledge of mathematical statistics to be employed effectively for informed decision making. Also, since risk and return are relatives ,they should be reviewed as a pair but this is not possible using Fund Facts* " Source : https://www.lautorite.qc.ca/files/pdf/consultations/anterieures/valeurs-mobilieres/81-324/gourley.pdf Numerous other letters from investors make the same point over and over again. Their voices should not have been discounted by the CSA.

Our primary argument is that fluctuations around a mean are not what long-term retail investors define as risk. Although the standard deviation is the basis for statistics and probability theory, its use as a measure of risk is currently in the middle of a raging debate. Theorists indicate that "outliers" near the tails of the conventional probability distributions are perhaps more frequent, and mathematics should account for these occurrences. Some academics are suggesting doing away with Bell distribution curves completely. Investors think of risk in terms of losing money or failing to meet objectives .

Since standard deviation is really a measure of up and down fluctuations, one could, theoretically speaking, have an investment that is smoothly declining to zero. In this case, because there is no zigging and zagging (no fluctuation), the graphical ruler could indicate a "low risk" fund. To carry the argument to an extreme, you could market the world's worst investment as a low risk, low volatility fund! Investors think of risk as the chance of a loss based on valuations and economic factors present at the time of being sold the fund. That is why we oppose using SD as the primary mutual fund risk disclosure. Our objection is not based on theory alone – investors have lost their savings by utilizing the FF rating.

We are supported by information from our Panel of Professional advisers. They tell us that although they appreciate many features of Fund Facts, they never use the risk rating when recommending a mutual fund. They tell us that getting involved with volatility discussions is time consuming and ineffective in ensuring that investors understand the risks involved. Other independent research confirms this (See References). We also note that submissions by SIPA, FAIR Canada. the OSC Investor Advisory Panel, mutual fund analyst Dan Hallett and individual investors are uncomfortable with the proposed risk rating methodology for use with retail fund investors. They are joined by Morningstar Canada , a leader in mutual fund analysis, rating and research who have expressed concern about unintended consequences in using a single standardized risk measure across funds [https://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20140312_81-324_mackenzies.pdf].

The Financial Planning Standards Council which represents CFP's had this to say " *While we appreciate the appeal of standard deviation as a risk measure, we advise against it as the sole measure for assessing risk. Given the low likelihood of consumers accurately translating this measure into possible real outcomes, we feel the use of standard deviation will run counter to the CSA's objective of providing investors with clear and meaningful information to help in making informed investment decisions.* [https://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20140312_81-324_financial-planning-standards-council.pdf] Finally, the Canadian Advocacy Council for Canaadian CFA Institute Societies which represents Certified Financial Analysts said : ' *However, we question the starting premise that volatility is the risk measure that should be required for the Fund Facts document. For example, an investment in Long Term Capital Management would have shown a low standard deviation just prior to its collapse, and thus low volatility risk does not necessarily mean that an investment is devoid of risk. We do not believe that most investors understand the meaning of standard deviation within the context of their portfolio, nor have a sufficient understanding to interpret the results*. " [https://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20140310_81-324_litvinova.pdf]

So, what we have is a situation where investors, investor advocates , consumer groups and the professionals that provide investment advice are uncomfortable with the proposal and yet it continues to breathe. We remain cautiously optimistic that the CSA will make adjustments to its proposal before implementation based on this Letter and the inputs of FF users.

As a possible replacement for standard deviation measurements, we have proposed the worst 12 months returns be published (or better the maximum drawdown) . It is published now but only for the worst 3 month period. That is far too short of a timeframe in our view. To really indicate the "riskiness" of an investment, we should know the maximum drawdown in percent over any period. As an illustration, most retail investors who consider an index-based fund would be staggered to know that the maximum drawdown for the S&P 500 index is an astonishing -56% . Most investors have already forgotten that the stock market dropped 56% from October 2007 to March 2009. Maximum drawdown disclosure numbers, without a doubt, would snap investors back to reality . We do not agree with the CSA that "SD is still the best general risk indicator and one that is useful as a first test to measure overall risk. " Indeed, as proposed , it is quite likely that an investor could end up comparing the " risk"(as represented by a word or set of words) of two funds, neither of which are based on real world data! That can't be good. One might as well establish a risk rating for each CIFSC Category and represent that as the risk rating of all funds in that Category. It would be just as inappropriate but would cost the industry much less to implement.

We believe behavioural finance, more than mathematical elegance deserves a place in defining the optimal risk disclosure methodology for retail investors. An understanding of fund risk is key to designing a suitable fund portfolio and that is why we are placing a heavy emphasis on its robust disclosure.

As we have expressed in our previous Comment letters on the POS project, “volatility risk” is only one of the material risks that a retail fund investor should consider before making an investing decision. One of the risks that weigh heaviest on the minds of most investors is the risk of losing part of their initial investment. But the returns of a mutual fund that loses 10% of its value each and every month would have a SD of zero and would be classified as low risk under the Proposed Methodology, even though such an investment would lose nearly all of its value over the course of a year. Our research and experience reveals that most retail investors would NOT consider such investments to be "low risk" investments. Sadly, other research suggests that retail fund investors chase past returns making the need for robust and clear risk disclosure even more important. According to OSC Investor Education Fund research (Reference 9) , Risk of loss is a major factor only for deciding NOT to buy. That is why clear, unambiguous disclosure of the potential for loss is so important.

A SD-based risk rating is NOT risk disclosure and it is not how retail investors perceive risk. If there is evidence otherwise, the CSA should present it.

Standard Deviation, Volatility and Risk
We dedicate this section to counter the arguments that volatility is meaningful under the “How Risky is it?” label in Fund Facts. Volatility refers to the amount of uncertainty or risk about the size of changes in a security's value. A higher volatility means that a security's value can potentially be spread out over a larger range of values. This means that the price of the security can change dramatically over a short time period in either direction. A lower volatility means that a security's value does not fluctuate dramatically, but changes in value at a steady pace over a period of time . It's useful when one is trying to write an equation, publish a paper or defend a thesis, but amounts to a vast over-simplification, one which threatens to put investors in harms way when used in FF's. While the use of volatility as a proxy for risk provides a statistical basis for describing the randomness of capital market movements, its reliance on assumptions and its demonstrably poor predictive power mean that volatility is both a weak proxy for risk, and an unreliable way to predict or reveal potential severe capital loss. It is therefore of limited or no use in matching funds to retail client portfolio needs.

The CSA calculation of volatility makes two big assumptions: first, that returns are normally distributed, and second, that correlations are stable. Neither is true. A cursory glance at equity return data over very long periods shows that the distribution of returns is subject to both skewness and positive kurtosis. This means that the typically used metrics of mean return and SD (volatility) do not fully describe the distribution of returns. To overcome this problem, advisors and investors need to spend less time looking in the rear-view mirror and instead focus on their instruments and the view through the windscreen. As volatility has become increasingly discredited, many investors are moving towards more sophisticated measures such as the maximum drawdown or 'mean conditional value at risk' that focus on the potential loss . Risk must once again become a conversation between the advisor and client rather than a simplistic 'tick-box' exercise which the chosen methodology actually discourages in our view.

The standard deviation does not fully address an investor's risk concerns. The field of behavioral finance has contributed an important element to the risk equation, demonstrating asymmetry between how people view gains and losses. In the language of prospect theory, an area of behavioral finance introduced by Amos Tversky and Daniel Kahneman in 1979, investors exhibit*loss aversion*- they put more weight on the pain associated with a loss than the good feeling associated with a gain. (read *Behavioral Finance: Prospect Theory*.) Thus, what investors really want to know is not just how much an asset deviates from its expected outcome, but how bad things look way down on the left-hand tail of the distribution curve. Value at risk (VAR)attempts to provide an answer to this question. The idea behind VAR is to quantify how bad a loss on an investment could be with a given level of confidence over a defined period of time. For example, the following statement would be an example of VAR: "With about a 95% level of confidence, the most you stand to lose on this $1,000 investment over a two-year time horizon is $200." The confidence level is a probability statement based on the statistical characteristics of the investment and the shape of its distribution curve. Not perfect but at least comes closer to the type of information sought by retail investors.

There are many asset price occurrences and events globally which occur outside the mean and with far greater frequency than typical option pricing theory suggests . Ironically, outlier events outside the mean can be sown by the seeds of persistent LACK of volatility. Additionally, recent research has uncovered the " Volatility Effect" wherein low volatility funds have outperformed higher volatility funds. Indeed, a number of such mutual funds and ETF's are on the market that exploit that effect. See "**The volatility effect: lower risk without lower return**" https://www.robeco.com/en/professionals/insights/quantitative-investing/low-volatility-investing/the-volatility-effect-lower-risk-without-lower-return.jsp)

In *Why Volatility does not Equal Risk* famed Berkshire Hathaway CEO Warren Buffett says volatility does not measure risk. Past volatility is not a measure of risk he says. It's nice math, but it's wrong. If a farm in Nebraska used to sell for $2,000 per acre, and now it sells for $600 per acre investment theory would say that the beta of farms has gone up, and that they are more risky than before. If you tell that to people, they'll say that that's crazy. But farms don't trade daily the way stocks do. Since stock prices jiggle around, finance professors have translated that into these investment theories. According to Buffet , risk is not knowing what you're doing. If you know who you're dealing with, and know the price you should pay, then you're not dealing with a lot of risk.
Read more: http://www.investorwords.com/tips/1594/why-volatility-does-not-equal-risk.html

In his most recent annual letter to shareholders , Mr. Buffett wrote about the difference between risk and volatility and how many investors conflate these concepts, costing themselves money." *Stock prices will always be far more volatile than cash-equivalent holdings. Over the long term, however, currency-denominated instruments are riskier investments – far riskier investments – than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is far from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray.* Does the CSA really want to challenge Buffet's powerful arguments and logic?

Peter Bernstein was an American financial historian, economist and educator whose development and refinement of the efficient-market hypothesis made him one of the best known authorities in popularizing and presenting investment economics to the general public . In **Can we measure risk with a number? ,** https://secure.halberthargrove.com/hh/announcement/FINAL%20T&M%20Q2%202007.pdf , Mr. Bernstein says the return of events – a replay of the patterns of the past seventy-five years of capital market history – will happen only for the most part. Most is not all. There is no certainty. Rational people do not bet the ranch on a model with an R2 of less than 1.00, that works out only for the most part. And God forbid it works out only for the minor part! Consequences, not probabilities, determine the decisions that matter. This is why it is critical not to characterize volatility as risk in FF and why we prefer stronger words concerning all aspects of risk disclosure in FF. Canadian's life savings are at risk with misleading and misunderstood risk disclosure.

For those who are drawing on their portfolio for income and have a shorter time horizon, volatility is certainly something to be cognizant of. These investors can't afford to have markets dip just when they need money. But for investors who have the luxury of time, volatility doesn't equal risk -these investors can hold assets with a higher potential return knowing that short-term price swings are inconsequential. Long-term returns are what matter and mutual funds are long-term investments. Risk is holding overpriced assets, being too concentrated on one type of investment, and having no protection against inflation. Risk is having a portfolio that doesn't fit with an investor's objectives. For long-term investors, in principle ,volatility shouldn't be a risk factor, but it clearly is. Dan Hallett of Highview Financial Group has done research that suggests investors in less volatile balanced funds have a longer holding period and achieve better returns than those in all-equity portfolios. Volatility is therefore related to investor behaviour but it is not risk and shouldn't be labelled as such.

One could argue that an undue emphasis on volatility is not a positive feature of the proposed risk rating regime. Volatility may be used to justify inaction or inadequate capital allocation, and prevent an investor from accessing opportunities that are suitable for his or her actual, but perhaps unrecognized, investment requirements.(Reference 8) . We recommend that the CSA focus its investor research initiatives on investor behaviour in order to provide better more effective regulation.

A mutual fund may be subject to certain risks that are not reflected in the fund's historic volatility, either because the risky event has yet to occur or because it is difficult or impossible for the market to factor the impact of those events into the fund's price. These risks include but are not limited to currency risk, concentration risk, fund governance, illiquidity and counterparty risk, and they are not well-suited to be explained in Fund Facts' summary form. This missing information is best communicated by a concise enumeration of the principal risks of the fund as we have suggested.

Also,while the consultation paper states that the reference index selected by the fund manager must satisfy certain principles, such as having returns and a risk profile that are highly correlated to the returns of the fund at issue, it is likely that the reference index will itself exhibit survivorship bias and could unduly inflate the risk performance of the fund at issue by smoothing out volatility.

The S&P/TSX Total Return Index, an index of the largest companies on the Toronto Stock Exchange by market capitalization, has an annualized 10-year standard deviation of about 13.9%. Under the previous CSA proposal this would have put the Index in the Medium to High risk classification according to the Proposed Methodology. Under the new proposal, the rating will fall to Medium .We believe that a risk rating of Medium to High risk would be more appropriate given the large downside witnessed in 2007-2008. The rationale of reducing the bands back to 5 escapes us other than its inconvenience to industry participants.

Here is further backup for our thesis that volatility (SD) is **not** a indicator of risk:

Why Volatility is Not an Accurate Measure of Risk : Morningstar UK
"By focusing on absolute levels of volatility as the key measure of risk, investors are prevented from buying risk assets when prices are low as these typically corresponded to periods of high volatility. Equally, portfolio managers are encouraged to buy risk assets when prices are high. This buy high, sell low strategy is unlikely to be in the clients' best interests.

The practical problems with this approach are especially evident when using absolute levels of volatility to match funds to client risk profiles. Morningstar has recently conducted research that shows that the volatility of a conventional multi-asset portfolio varies widely through the market cycle. We created a series of multi asset portfolios and tracked their volatility using the approach stipulated for the calculation of a fund's synthetic risk return indicator (SRRI) that is included in key information documents (KIID). The volatility of these portfolios varied significantly over time. For example, the volatility of a moderate risk portfolio comprised of recognised benchmark indices varied by 5.3% over the last 9.5 years. This volatility range is greater than the SRRI band (four) used to classify the fund.

This means that a portfolio positioned in the middle of an SRRI band at the beginning of

the period and rebalanced regularly would breach both the upper and lower boundaries of that band over the period. In other words, without changing the allocation, the portfolio fund would be both too risky and not risky enough for the same client over the period. **A risk mapping process that produces such widely varying results for a stable portfolio is clearly not fit for purpose.**"
http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx#sthash.bCVr86mV.dpuf
http://www.morningstar.co.uk/uk/news/134560/why-volatility-is-not-an-accurate-measure-of-risk.aspx

Volatility does not measure true risk: 300 Club
http://www.the300club.org/newsevents/tabid/79/vw/1/itemid/31/300-club-volatility-does-not-measure-true-risk.aspx

The Greatest Trick the Devil Ever Pulled …was convincing investors that volatility and risk were the same thing
http://thereformedbroker.com/2015/05/06/the-greatest-trick-the-devil-ever-pulled-2/

Understanding Volatility Measurements
http://www.investopedia.com/articles/mutualfund/03/072303.asp

Never confuse risk and volatility | Reuters
http://www.reuters.com/article/us-saft-on-wealth-idUSKBN0H52AL20140910#864ZMketssTXUyD9.97

Is volatility risk?
http://www.schroders.com/en/SysGlobalAssets/digital/insights/pdfs/investmenthorizons-is-volatility-risk-nov2014.pdf

The Volatility Anomaly Uncovered |Swedrowe ETF.com
"..Recent academic papers have shown that low-volatility stocks have provided better returns than higher-volatility stocks. What's more, this is a global phenomenon. These findings, however, run counter to economic theory, which predicts that higher expected risk should be compensated with greater expected returns, resulting in the low-volatility anomaly. Of interest is that this finding holds true not only for stocks, but for bonds..."
http://www.etf.com/sections/index-investor-corner/swedroe-volatility-anomaly-uncovered?utm_source=newsletter&utm_medium=email&utm_campaign=dailynewsletter

Confusing risk with volatility
http://www.trendfollowing.com/whitepaper/confusion.pdf

Volatility is not the same as risk
http://www.kamny.com/load/publications/p03_eng

Volatility Is The Square Root Of Time & Fat Tails | Zero Hedge
http://www.zerohedge.com/news/2015-04-25/volatility-square-root-time-fat-tails

On time-scaling of risk and the square–root–of–time rule *
http://eprints.lse.ac.uk/24827/1/dp439.pdf

Even if volatility related to risk there is a fundamental issue because so few funds have a 10 year life. The length of the time period used to calculate the SD is therefore a forced trade off between consistency and relevance of data. The CSA proposal uses 10-year SD while the IFIC Guidelines use 3-year and/or 5-year SD. According to industry sources, only about 20% of mutual funds have been around for 10 years, while only about 4% of exchange-traded funds (ETFs) have a 10-year life. **This means that under the CSA proposal, the majority of funds will have their risk rating based on a proxy not actual fund data.** This is an issue for actively- managed funds or funds that track new indexes that do not have a 10-year track record. About 40% of mutual funds have at least five years of history, while 55% have at least three years of history. We note that this means that the risk classification of a new or newly created mutual fund would be based entirely, or mostly, on the reference index, although we foresee significant practical difficulties in determining which reference index to use for such mutual funds, given the CSA's proposed guidelines for selecting a reference index: Thus , new funds will effectively be given a rating that is based on an index which kind of makes the rating a bit of a sham. This is one more reason why we remain concerned about this system.

One of the asserted benefits of using a 10-year SD is that it eliminates much of the variation in the measure itself. This means that risk ratings should be more consistent, even if the market goes through extended stretches of either high or low volatility, and eliminates the need to adjust the SD bands periodically. In contrast, using 3-year and/or 5-year SD under the IFIC Guidelines allows for the risk measure to capture recent volatility trends in the market and might follow more closely with what retail fund investors actually experience. We would not have thought of this as a bad thing. In addition, the 10 year measurement may be inappropriate as many investors do not hold any one mutual fund for a 10 year period. A study of mutual funds in Canada conducted by Investor Economics for the Investment Fund Institute of Canada in a September 2012 report, used an average holding period of 4.5 years. If the CSA retains the SD approach, consideration should be given to a 5 or 6 year period as a pragmatic trade off.

Further, since downside risk statistics are impacted as fees rise, it is important to consider risk indicators for each individual fund and specific fund class. Differing MER's will necessarily impact statistics such as time to recovery, as well as other indicators, yet standard deviation does not capture these significant differences in real risk to investors based on the often material fee differentials that are inherent in different classes of the same fund.

Frequent changes to risk ratings are certainly not desirable, and risk ratings should be as consistent as possible. But at the same time, investors should be alerted as soon as possible to shifts in volatility rather than having to wait until an arbitrary date that the company uses as its fiscal year end. We believe the CSA proposal conveys this message by allowing upward changes in risk to be decided by fund managers enabling them to increase the risk rating even if the formula does not reveal the enhanced risk . It is hoped that PM's will take advantage of this exception but if a higher risk rating results in a competitive disadvantage, it's not obvious this will happen .

If the CSA proposal comes into effect despite our recommendation; then we recommend that the FF section on “Risk” be changed to something like the following:

How volatile is it? The value of the fund can go down as well as up. Volatility refers to the amount of uncertainty or market risk about the size of changes in a fund's value over a specified time period. A higher volatility means that a security's value can potentially be spread out over a larger range of values. This means that the price of the fund can change dramatically over a short time period either positively or negatively .A lower volatility means that a security's value does not fluctuate dramatically, but changes in value at a steady pace over a extended period of time. Volatility does not measure the direction of price changes, merely their dispersion. Research is unclear as to whether or not higher volatility or lower volatility has a more significant impact on long-term fund returns.

Volatility rating

This rating is based on the fund's historical volatility . It doesn't tell you how volatile the fund will be in the future. The rating can increase or decrease over time. Volatility is not the same as risk .Factors such as interest rates, currency fluctuations, Portfolio Manager changes, fund governance or the nature of the fund's mandate/objectives may influence risk and returns .A fund with a low risk rating may still provide superior results..Volatility presents opportunities to buy funds cheaply and sell when overpriced. The fund's risk rating should always be read in conjunction with the fund's performance .

COMMENTS

Here are our main Comments:

The Methodology of Assigning Fund Risk Ratings is Unproven, Raising Concerns About the Efficacy of the Ratings : The proposed methodology in assigning mutual fund risk ratings is a relatively recent invention with observed field tested deficiencies. Because of actual marketplace experience with fund risk ratings, there is no basis for confidence about the robustness of the ratings. Ratings based on a single parameter such as standard deviation /volatility are not fully tested, and it is not at all clear that they will be sufficient to protect investors when market conditions change. We note that the U.S. SEC decided, after extensive consultation, not to use numeric or alpha symbols to depict mutual fund risk. Instead, they require the principal risks to be enumerated in the Fund Summary Prospectus Document .

Volatility risk rating will be hard to interpret The proposed methodology suggests that in the event a fund does not have a 10 year history, its manager will be permitted to utilize the monthly returns of an appropriate reference index as a proxy to impute missing data. When the performance of a benchmark index is integrated with the historical actual returns of a fund, it complicates matters as it does not allow investors to determine if the manager's active management style adds volatility to the fund or whether that is a function of its benchmark index selected. The longer the performance history reflects data from the chosen index the less relevant any comparison between the fund's returns and those of the benchmark.

Investor exposure will be increased : Investors have paid a heavy price for what we believe is misleading risk rating (posing as a risk disclosure) . In numerous complaint cases , Dealers/salespersons have utilized Safe Harbour protection to deny redress to victims. Given the choice of word descriptors in the CSA risk rating scale, investors and registered representatives have confused these with similar sounding words on NAAF/KYC documents used for critical suitability determinations. This has led to investor losses and complaints. Risk ratings should NOT equate with suitability – medium risk tolerance person does not mean that a medium (or less risk) rated fund is ipso facto suitable. Product risk rating based on SD does not equate with KYC risk tolerance. Regulator suitability guidelines should avoid referring to FF risk ratings in compliance exams and client complaint investigations. Therefore, we strongly recommend that the CSA's accompanying guidance make clear that the risk classification brought about by the Proposed Methodology, cannot be directly linked to the investor's risk tolerance derived from his or her KYC/suitability risk profile; overall compliance must be judged more holistically.

The proposed disclosure continues to employ word descriptors but no counter argument to our documented concerns has been provided by the CSA. We have suggested using numbers rather than text for risk ratings if this methodology is to be utilized , to partially mitigate this well identified problem. A sliding scale with 10 buckets showing SD's from 0 to 20+ might at least be a better visual presentation. Bucket one would be labeled LOW volatility and the tenth bucket would be labeled HIGH volatility . The CSA might even consider including the actual SD numeric statistic in brackets. While it may not be very valuable to most investors, it should be very valuable to advisors.

Prevailing investor risk profiling practices are weak : New research (Reference 3) from the OSC-IAP suggests the Canadian investment industry lacks objective standards for defining and assessing clients' risk tolerance and that the questionnaires that are used by many advisors aren't up to the task. The research study included an industry survey, a regulatory review and an examination of academic literature. The report, which was prepared by PlanPlus Inc., finds that the task of properly assessing a client's risk profile is a primary area of concern in the industry, and that regulators say it is an area of "high importance." **The research found that many risk concepts do not have a standard definition and that there is a lack of understanding of the factors**

involved in assessing clients' risk appetite. While risk questionnaires are widely used in the mutual fund dealer channel, the report found, the vast majority (83.3%) of these questionnaires "are not fit for purpose." The report found that these surveys have too few questions, use poorly worded or confusing questions and involve arbitrary or poorly conceived scoring methodologies. More than half (55%) of risk questionnaires have no mechanism to identify highly risk-averse clients who should be invested solely in cash.

With questionable risk profiling, the FF risk disclosure becomes the last line of defence. Since we argue that the fund risk rating is not robust , investor protection will be compromised.

This proposed Disclosure does not comply with IOSCO POS disclosure principles. If the CSA are determined to use a risk rating metric, there is a need to do more than merely describe volatility risk in the risk section. IOSCO's Principle 1 states: "***key information should include disclosures that inform the investor of the fundamental benefits, risks….Its risk and reward profile. Risk disclosures should include the material risks for the product.*** *This may include performance risk/volatility, credit risk, liquidity risks and operational risks.* ***In some jurisdictions, a scale may be considered appropriate to identify the overall risk measurement or classification of the product, rather than a list of specific product risks, and this may be accompanied by appropriate narrative explaining <u>how to interpret the scale</u>. This may assist with risk comparisons, although regulators and investors need to be aware of the inherent limitations in such measures.[footnote] Regulators might wish to include supporting information indicating minimum length of holding relative to short term volatility, what types of "targeted investors" the product is being marketed to and what commitment those investors need to make;…*** *"* The proposed Fund Facts risk disclosure appears to downplay IOSCO's wise counsel.

IOSCO report on risk education examines what constitutes risk in the mind of the retail investor
In September 2015 ,the Board of the International Organization of Securities Commissions (IOSCO) published its final report on Sound Practices for Investment Risk Education. The report identifies a number of sound practices for investment risk education initiatives, based on an analysis of the approaches and practices adopted by the members of the IOSCO Committee 8 on Retail Investors in designing and delivering their investment risk initiatives, as well as a review of literature on the topic. IOSCO has long recognized investor education as a key strategy for enhancing investor protection, promoting investor confidence and fostering investor engagement in financial planning and decision-making. Investor education is complementary to other tools such as regulation, supervision and enforcement, and is recognized in IOSCO´s guiding principles for securities regulation. In 2013, IOSCO created Committee 8 to conduct its policy work on retail investor education and financial literacy. Here's what's interesting – they say " **For the purpose of this report, "investment risk" is generally defined as the risk that an investment will not deliver the expected yield and/or lose value and**

comprises a range of underlying factors. "
https://www.iosco.org/news/pdf/IOSCONEWS398.pdf So, if investors are going to be educated on risk on this basis, why disclose risk using volatility of returns (SD approiach)?

Hallett research points out some issues with SD method (Reference 4) In the referenced article respected fund analyst Dan Hallett says " A system designed to truly inform and protect investors would look far back enough to capture bear market performance either for the fund or – if it's too new – for its benchmark. Combining this with a more common sense measure – i.e. how much a fund lost in its last big decline – puts these new risk ratings in a different light..." The current proposal does increase the period to 10 years thus partially alleviating part of the disclosure problem but it is still missing the common sense measure – maximum drawdown. In our prior submission we argued that the maximum one year loss be provided as an investor-friendly way to communicate risk . No rationale has been provided by the CSA for not accepting this recommendation.

Risk and return are related : If the SD word descriptor is provided, we feel that the other descriptive statistic, the mean return , of the Bell curve should also be provided. It is not reasonable to expect an investor to make an informed decision using only the SD -based risk rating. It could very well be that risk is MEDIUM but return is well above that of an alternative fund being considered. This statistic should be provided even if the figure is partially determined by using augmented index data . Imperfect to be sure, but better than no disclosure.

Risk disclosure can be partially located in performance section: We recommend adding this sentence in the performance section of FF " ...This information provides some information of the risk of investing in this fund.." We would also add a note " Results do not include a sales charge; if a sales charge were included , results would be lower".

Floating Rate Note Funds illustrate the deficiency: In *INDUSTRY RISK RATING FAILING INVESTORS OF FLOATING RATE NOTE FUNDS* http://www.highviewfin.com/blog/industry-risk-rating-failing-investors-of-floating-rate-note-funds/ the author stated :" My critique of the fund industry's approved risk rating method is not new. Six years ago – before the worst of the financial crisis – I took the industry to task for its meaningless risk and suitability ratings .Then as now, Fund Facts' oversimplification of these two ultra-important factors does not tell investors what simple numbers can clearly communicate. Fund sponsors should use sufficient history (of the fund or its benchmark) to include at least one bear market in assessing a fund's risk rating for investor disclosure documents Investors may not immediately comprehend credit spreads and spread compression. But they understand losing money – and that's what the industry should be showing them before they invest." We couldn't have said it any better ourselves. We feel showing the worst 12 months performance over at least the last ten years would be a huge improvement over the confusing word risk rating disclosures being proposed. See also Reference 5 .

Bond fund risk ratings a concern : Bond mutual funds typically make up 40 % of a balanced portfolio; even higher for seniors/ retirees. We argue that 'a risk rating that represents a judgment of how a Bond fund will react to changes in various market conditions is a necessary disclosure. Unlike bond credit ratings, which reflect credit risk, Bond-fund risk ratings reflect the variability of returns. The CSA proposal rates Bond fund risk based solely on past volatility. The main risk with bonds and Bond mutual funds is interest rate risk and we are currently at near record lows. If rates rise which is about the only way they can go from here, Bond funds will lose value. Interest-rate risk - the risk that a bond's or bond fund's share price falls when interest rates rise - can be very painful if you are invested in a long-term Bond fund when rates rise significantly, as they did in 1994.We therefore are concerned that Bond fund risk ratings based on SD would put the most vulnerable of investors , retired investors, in harms way.

Volatility ratings of Bond funds are also difficult to use by retail investors; they are not institutional investors who are in a position to understand the basis of, and limitations inherent of such ratings. Less sophisticated investors are likely to be misled, and to take a Bond fund volatility risk rating as a depiction of the risk most significant to them, when such in fact is not the case. As the CSA is well aware a number of factors can affect the value of a Bond fund. These include, for example, credit risks; interest rate risks; liquidity risks; currency risks (for foreign bonds); political risks; risks from call or pre-payment provisions; risks from the use of leverage, options and derivatives; risks arising from over concentration (lack of diversification); and operational matters .

It has been our experience that Bond fund investors will assume, from their experience in other contexts, that a "Low" risk rating means "superior" and make their investment decisions accordingly. Indeed, in the context of credit ratings, a triple-A rating for a bond really does mean "superior." It would only be natural, therefore, for investors to draw the same conclusion with respect to Bond fund risk ratings. A basic premise underlying bond investors is that have a strong sensitivity regarding the current values of their fixed income investments to changing long -term interest rate trends .A low risk rating for a Bond fund at a time of record low interest rates is misleading to unsophisticated retail investors in our view.

An example of this can be found in Reference 7. In the example, the author shares our concern. Like us, he argues that any investment that has generated strong double-digit returns should not be considered LOW risk. This misleads investors into thinking that low risk and high return is a reasonable expectation. More importantly, the rating doesn’t adequately inform investors about the risks that lie ahead during the next credit market freeze or when the PIMCO managers show their humanity and get some of their bets wrong. Assessing this fund as a low risk fund simply shows the investor protection inadequacy of the SD risk rating methodology **.**

Target date fund issue(s) not adequately addressed : As we pointed out in our prior submission ,Target Date funds are unique as they have an end date and a planned approach to decrease risk over a defined time period. As these funds move though their glidepath ,risk is changing in such a way that past returns and SD are irrelevant to future performance. We had also argued that in regard to Target date funds (TDF), one of the associated risks is a premature movement to a safe mode (a "triggering event") which happened in 2008 -- such a risk is not captured by SD. This event left investors in a fund that had no chance of recovering or meeting its target. The lack of any reference to this possibility in the FF risk disclosure would leave investors exposed without any warning. It is the terms and conditions that present a real risk for TDF's. Further, TDF's are designed such that their risk level changes over time, so a backward looking risk measure may not be a suitable indicator of product risk as it will overstate the designed risk profile (per the anticipated glide path) of the fund at a point in time. Instead of looking at volatility for these types of investments, it is important that consumers understand the fund's strategy and attendant implications. The CSA response does not match reality since the whole purpose of a TDF is not to have a constant risk rating over its life cycle. Without seeing the CSA analysis, it is hard for us to accept the CSA argument that the methodology is useful and meaningful. To us ,it looks like this is an attempt to force a square peg into a round hole.

In our comments on ETF Facts we pointed out similar problem rating structured funds like leveraged and reverse ETF's.

Return of Capital (ROC) /T-series fund issue(s) not addressed : We based our concern on the established fact that there have been so many investor complaints and regulatory proceedings about these funds, especially from retirees. The Return of Capital (ROC) issue is a serious one especially when coupled with misleading marketing materials .The CSA argument that in the 2013 Proposal there are provisions that allows for discretion to use a reference index as a proxy for missing information that best fits the risk profile of such funds. The reference index can , the CSA argues, be a single index or a blend of indices that best fits the risk profile, and therefore, should allow an index to be customized to the risk profile of the fund. This is not the point we are making. ROC funds have left yield hungry seniors with funds that invariably declined in value due to excessively advertised " distribution yields" . This had led to much grief.

Many ROC funds have had to reduce "distributions" leading to investor complaints of misrepresentation .Kenmar have long taken exception to such funds with their two-fold objective of providing investors with monthly cash flow and the potential of capital appreciation. We have argued that such funds handed investors so much of the monthly cash flow that it left no room for its secondary objective of capital appreciation. Accordingly, unit prices have fallen over the years and this shocks investors, not to mention the many tax reporting challenges that result. We see nothing in the proposed FF risk rating disclosure that would warn income seeking investors of this material risk or prevent the sort of problems that have already occurred. Please refer to Reference 6. In our view the chosen methodology actually masks the threats to investors.

DSC fund fee disclosure takes up a lot of space: DSC- sold funds have caused investors a lot of grief. A recent MFDA bulletin paints a sorry picture of investor abuse . Nevertheless, we feel this disclosure consumes a disproportionate amount of page space. The good news is that the sale of such funds is in decline on an absolute and relative basis and the FEL version is available with typically a 0% upfront sales charge. There is also a distinct possibility such funds may be prohibited under proposed regulatory reforms. Until that happens, we recommend that the fee disclosure be compressed providing valuable space for inclusion of a concise statement of the principal risks of the fund.

A condensed table could be provided showing the number of dollars of early redemption penalty per $100 or $1.00 of investment for each year of the redemption schedule. A brief note could also be added pointing out the 10% annual penalty -free provision if it is applicable. With these minor changes and some creative formatting , FF could end up as an excellent document and still stay within the 2-sheet constraint. If the top 3 or 4 risks were revealed with a note telling the investor to refer to the Simplified Prospectus for more detail , Safe Harbour could be provided to dealers and advisors regarding risk disclosure, at least so far as FF pre-sale delivery is concerned.

Provide a brochure/Guide on how to use Fund Facts : In *Risk appetite and attitudes of Retail investors with special reference to Capital Markets* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1820862 we read “The retail investor's understanding of the way in which markets work, the nature of risk ,the pricing risk and utilizing risk information in a way that's appropriate to their own circumstances, is still something that is missing-we've got a long, long way to go” .This is one reason Kenmar have suggested a plain language CSA brochure GUIDE on how to effectively use Fund Facts particularly the risk elements of the FF document. The Guide could expand on the DSC , risk, volatility risk and its inherent limitations and as a bonus, a section on any sales charge or fee discounts available to larger investors /families. Again, the CSA makes no mention of this recommendation that we've made several times in the past. We urge the CSA to provide such a Guide. It would be an excellent and sorely needed complement to FF.

Although it is not the focus of the consultation , we take this opportunity to again strongly recommend that the FF language regarding conflict -of-interest risk in trailing commission payments needs to be strengthened. This risk can be of more importance than the volatility risks which are the subject of the consultation and the DSC disclosure that takes up so much page space. Despite an overwhelming body of evidence, the investment industry has persistently refused to acknowledge that these trailing commissions can harm mutual fund investors. Now, that acknowledgment is no longer necessary because of the comprehensive empirical research that Douglas Cumminga , a finance professor at the Schulich School of Business at York University in Toronto, has completed for the CSA.

Cummings and two colleagues sifted through a decade of data from 43 mutual fund companies that manage two-thirds of fund assets in this country. The three key findings of this research align with a mountain of what other independent research have been saying for well over a decade :

1. Mutual funds that don't pay trailing commissions tend to get investment inflows if the funds perform well and lose inflows if they underperform. But it's a different story for funds that pay trailers. Investment inflows gravitate toward those funds even if they perform poorly for investors.
2. This gravitational effect increases as funds pay higher trailing commissions.
3. Where funds are able to attract investment inflows without having to do so through strong performance, their performance worsens. This occurs frequently in funds that pay trailing commissions.

In other words, trailer commissions skew mutual fund flows by letting sales incentives drive "advisor" investment recommendations, and this channels many investors toward more expensive funds exposing them to higher risks and lower returns. Trailers harm investors, and the market as a whole, by facilitating deterioration in fund performance that ultimately impairs retirement income security. These are profoundly serious findings that regulators cannot ignore in any consideration of mutual fund risk disclosure in FF. "Advisor risk" is clearly a material risk of investing in a mutual fund in Canada. We continue to favour the SEC mandated disclosure in the Summary Prospectus which is more forthright than the prevailing disclosure in FF: **"Payments to Broker-Dealers and Other Financial Intermediaries. If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."**

This strong warning may also mitigate the use of advisor titles designed to mislead investors as to the level of proficiency or advice standard applied.

We add parenthetically that NI 81-105 *Mutual Fund sales Practices* allows a member of the organization of the mutual fund to pay participating dealers the costs of marketing and educational events within prescribed limits and also organize and present conferences or seminars for the sales representatives of participating dealers provided certain conditions are met. In our experience, " Free lunch" educational seminars are bringing harm to elderly and other vulnerable investors and ask again for this NI rule to be reviewed as it increases mutual fund investor risk.

Conclusion

In conclusion, we continue to warn of the inherent dangers of using a SD -based risk rating methodology to answer the question " How risky is it?" for mutual funds. The use of a word(s) that attempts to be a single, all encompassing measure of fund risk, without a clear explanation of how the word(s) or number was derived or its meaning, or how to use it provides little useful information to investors. As we have reported numerous times, retail FF users (and even some advisors) tend to rely too heavily on such a single measurement of risk without a true understanding of the risks involved. We have provided numerous constructive ideas to improve FF's investor protection attributes.

As we have pointed out ,one major risk that investors tend to overlook is asset allocation/diversification risk. For example, an investor with a low risk tolerance/capacity may, based solely on the traditional risk rating in Fund Facts, select a variety of Bond funds. This type of behaviour leaves the investor particularly vulnerable to loss of capital in a rising interest rate environment, and a investor who does not understand the link between yield and price could feel that the low risk rating was misleading, harming their confidence in financial markets, fund manufacturers and securities regulators. We believe our recommendations would address this issue.

We do not believe that a fund risk rating improves the ability of investors to appreciate the risk(s) associated with a particular fund. Investors that rely on Fund Facts, using the Proposed Methodology, will be seriously deficient in the vital information they need before making an informed investment decision .Changing the section title to Volatility risk alleviates a part of the confusion problem. In fact, RRIF investors might find the section useful, after some rewrite, due to the importance of Sequence of Returns in de-accumulating accounts.

At numerous points in FF's where a risk related disclosure is cited, the light touch has been chosen by the CSA. When one combines poor definitions of risk, deficient risk profiling processes with misleading risk disclosure , critical academic research , actual field failures , criticism from professional advisor Associations and the lack of a Best interests standard for advisors, the unsuspecting retail mutual fund investor will be the loser. The CSA should not allow this to happen if it remains true to its investor protection mandate. We sincerely hope the CSA will give due consideration to our recommendations which are based on real world investor experiences.

In our opinion, investors would get more out of just seeing a chart showing the loss experience of the fund and its benchmark with the main risk factors expressed in plain language. That is essentially what we what we recommend.

It is important for the CSA to be realistic in its communications about the fund rating: it is not a mechanism for retail investors to learn about and understand all of the material risks they need to know before making an informed investment decision. As we have demonstrated ,there are other major risks beyond volatility risk which are not necessarily expressed in the fund's price movements. Maximum Drawdown or the worst 12 month figure (10-years) may be helpful in capturing these aspects of risk as would a delineation of the principal risks of the fund (not just market risks).

We grant permission for public posting of this Comment letter

Should the CSA have any questions, do not hesitate to contact us.

If the CSA establish a meeting or multiple stakeholder Roundtable to discuss these investor-critical issues, we will be glad to participate.

Kenmar strongly supports the CSA in making Fund Facts a world- class document.

Ken Kivenko P.Eng,
President, Kenmar Associates

Kenmar Associates is an Ontario- based privately-funded, non-profit organization focused on investment fund investor education via on-line research papers hosted at www.canadianfundwatch.com.Kenmar also publishes ***the Fund OBSERVER*** on a bi-weekly basis discussing investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims. Kenmar advocates on behalf of the retail investor.

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2. **Principles on Point of Sale Disclosure Final Report :** IOSCO Feb. 2011
https://about.investorpos.com/documents/IOSCO%20Principles%20on%20Point%20of%20Sale%20Disclosure%20Final%20Report%2001022011.pdf

3. OSC -IAP Report on Risk Profiling
Current Practices for Risk Profiling in Canada and Review of Global Best Practices
The research found:

- There is a confusing and universal lack of existence or consistency of the definitions of risk concepts and a lack of understanding of the factors involved in risk profiling.
- Almost all regulators surveyed are principles-based and provide little guidance on how a firm or advisor should arrive at the determination of a risk profile. They all recognize and rely on the professional judgment of the advisor and the 'process' created by the advisor or firm to determine a consumer's risk profile. No regulator provides clear guidance on how to combine the multiple factors and form a client risk profile.
- Risk questionnaires are most widely used in retail channels using mutual funds and less so in wealth management and portfolio manager channels.

- Over 53% of respondents to the advisor survey indicated that between 76-100% of their clients had completed a risk questionnaire. Almost half of the firms reported that risk questionnaires were developed in-house and another 36% said that advisors could choose their own risk profiling methodology. Only 11% of firms could confirm that their questionnaires were 'validated' in some way.
- Most of the questionnaires (83.3%) in use by the industry are not fit for purpose - they have too few questions, poorly worded or confusing questions, arbitrary scoring models, merge multiple factors (75%) without clarity or have outright poor scoring models. Fifty five percent had no mechanism to recognize risk-averse clients that should remain only in cash.

The research report offers examples of best practices in other jurisdictions and concludes with recommendations for regulators, industry and the academic community.

4. Investors need more meaningful risk measures

Dan Hallett Special to The Globe and Mail Published Thursday, Jul. 23, 2015 3:06PM EDT

The measurement and communication of risk for investment funds is high on securities regulators' radar. They continue to review this important issue and we're awaiting their final decision. It's striking how many years have passed and yet the industry continues to debate many of the same issues.

In 1997, I started working for a firm that was trying to move the industry away from opaque academic risk measures like standard deviation to more common-sense methods. I have written several times that the industry standard risk measure and illustration are inadequate and meaningless. The announced changes in fund risk ratings offers plenty of new evidence to support my argument.

I tracked risk rating changes on 44 mutual funds since last October. The table below lists the affected 28 unique funds – excluding 16 funds that are simply other incarnations of the 28 – and summarizes the risk rating changes and related risk statistics.

Desktop users click on image to enlarge

Fund Name	Direction	Previous Risk Rating	New Risk Rating	Risk Rating Method	Biggest Drop in Value	Time Under Water
Franklin Bissett Canadian Balanced	↓	Low-to-Medium	Low	Historical Volatility	-28%	2 years & 4 mos
Franklin Bissett Canadian All Cap Bal	↓	Low-to-Medium	Low			
Franklin Bissett Canadian High Dividend	↑	Low-to-Medium	Medium		-35%	1 year & 9 mos
Franklin Bissett Dividend Income	↓	Low-to-Medium	Low		-25%	1 year & 10 mos
Franklin Quotential Balanced Income	↓	Low-to-Medium	Low		-23%	2 years & 5 mos
Franklin Quotential Diversified Equity	↓	Medium	Low-to-Medium		-44%	5 years & 7 mos
Franklin World Growth	↓	Medium	Low-to-Medium		-46%	3 years & 11 mos
Templeton Asian Growth	↑	Medium	Medium-to-High			
Templeton BRIC	↑	Medium-to-High	High		-52%	still recovering (after 7.5yrs)
Templeton Global Bond	↓	Low-to-Medium	Low		-13%	3 years & 7 mos
Templeton Global Smaller Companies	↑	Medium	Medium-to-High		-55%	6 years & 3 mos
Sprott Enhanced Equity	↓	Medium	Low-to-Medium	Historical Volatility		
Sprott Enhanced Balanced	↓	Low-to-Medium	Low			
NEI Select Conservative Portfolio	↓	Low-to-Medium	Low	Historical Volatility	-17%	3 years & 6 mos
O'Leary Canadian Dividend	↓	Medium	Low-to-Medium	Historical Volatility		
O'Leary Canadian Balanced Income	↓	Low-to-Medium	Low			
O'Leary Conservative Income	↓	Low-to-Medium	Low			
O'Leary Global Dividend	↓	Medium	Low-to-Medium			
O'Leary Emerging Markets Income	↑	Low-to-Medium	Medium			
RBC O'Shaughnessy U.S. Growth Fund	↑	Medium-to-High	High	Historical Volatility	-66%	still recovering (after 7.2yrs)
RBC Private O'Shaughnessy U.S. Growth Equity Pool	↑	Medium-to-High	High			
MDPIM Canadian Bond Pool	↑	Low	Low-to-Medium	Historical Volatility		
MD Strategic Yield	↑	Medium	Medium-to-High			
MD Precision Moderate Growth Portfolio	↑	Medium	Medium-to-High			
Standard Life Diversified Income	↓	Low-to-Medium	Low	Historical Volatility	-17%	1 year & 6 mos
Standard Life U.S. Dividend Growth	↓	Medium	Low-to-Medium		-33%	5 years & 8 mos
Standard Life Canadian Equity Growth	↓	Medium-to-High	Medium			
Standard Life Canadian Equity Value	↓	Medium-to-High	Medium			

Multiple versions of funds (i.e. trust, corporate class, series F, series T, series A, etc.) are excluded for brevity. Risk stats are calculated on longer running version.
Raw data source: GlobeInvestorGold.com

Nearly 2/3rds of the affected funds saw falling risk ratings with just over 1/3rd seeing a bump up in risk rating. In my view, an investor's exposure to risk should not fall after a multi-year run up in prices. A case can be made for risk being higher since we are likely closer than not to the next significant price drop.

But since the industry remains stuck on measuring risk using standard deviation – and applied to arbitrary scales – fund sponsors are blindly lowering risk ratings in droves. And risk ratings will only rise under this system after the worst of the next decline has already occurred – i.e. when it's too late.

Those using the industry standard risk rating method will update volatility measures annually. If volatility has fallen sufficiently over the past three or five years, there's a good chance the risk rating will fall. The thing is that usually volatility falls during bull markets and rises during bear markets. By the time this is captured by fund companies' annual updates, investors will have already been hurt. Even worse, when bear markets fall out of the three and five years periods used to assess risk, standard deviations are bound to fall.

A system designed to truly inform and protect investors would look far back enough to capture bear market performance either for the fund or – if it's too new – for its benchmark. Combining this with a more common sense measure – i.e. how much a fund lost in its last big decline – puts these new risk ratings in a different light.

Of the 28 funds in the above table, 13 have enough history to look at past bear markets. Six of these 13 funds sport a new "low" risk rating. These six so-called "low risk" funds lost an average of more than 20% in the last bear market and spent 2.5 years under water. I don't know anyone who considers this low risk. The few other funds that were re-assessed as having "low to medium" risk sport an average bear market loss of more than 41% and spent more than 5 years climbing back to the previous high.

If the industry continues to argue – as most fund companies have – that the standard risk rating method works well, they will need to rethink the purpose of these ratings. All fund companies are legal fiduciaries. Yet a true fiduciary mindset would attempt to measure and illustrate risk in ways that better inform investors.

In my submission on this topic to Canadian Securities Administrators last year, I clearly outlined the weaknesses of the status quo and provided strong arguments for with examples of more meaningful solutions (e.g. see page 4 of my submission). The latter reflects what we show to clients both before they engage our services and through our periodic reporting. It's time for the broader fund industry to abandon its opaque technical approach and become more investor-friendly so that its end clients can better grasp risk before they invest.

Dan Hallett, CFA, CFP is a principal with Oakville-Ont.-based HighView Financial Group, which acts as an outsourced chief investment officer for wealthy families and foundations. He also contributes to The Wealth Steward blog.

5. **Illiquidity may be floating rate funds' biggest risk**
http://www.highviewfin.com/blog/illiquidity-may-be-floating-rate-funds-biggest-risk/

6.BMO income fund sets yield bar unreachably high
http://www.theglobeandmail.com/globe-investor/investment-ideas/experts-podium/bmo-income-fund-sets-yield-bar-unreachably-high/article2207946/

7. **Lowering of PIMCO fund's risk rating illustrates need for reform** - The Globe and Mail
"...I have written many times over the past several years about the shortcomings of the prevailing method of assessing and communicating risk to mutual fund investors. I felt strongly enough about this to make a personal submission to regulators to share my thoughts on this important issue. A recent change to one popular fund's risk rating simply confirms the weakness of the current risk rating method and the need for legislated meaningful risk measures...."
http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/lowering-of-pimco-funds-risk-rating-shows-why-reform-is-needed/article17830350/

8. How do you measure risk ?: Sentry Investments
" Volatility is not the only measure of risk. The most important risk an investor can examine is: *"Will my current capital allocation enable my portfolio to maintain my purchasing power through the inevitable business cycles of life?"* The aggregate pension

portfolio is well structured to provide duration in the income stream together with sufficient growth in income to build capital and deal with benefits increases over time. The aggregate retail portfolio is very similarly placed when you look at the asset mix with balanced funds allocated to their underlying components. Mutual fund flows over the past five years indicate that the broad population is investing new capital in a very conservative manner.I hate to say this but I suspect a lot of 30, 40 and 50 year olds are investing as if they were already running a retirement portfolio. The fear of volatility is preventing appropriate risk taking at a point when investors have ample time for capital to accumulate over multiple cycles.".https://sentry.ca/en/portfolio-team/market-commentary/commentary-view.html?com=3462

9. Investor behaviour and beliefs: Advisor relationships and investor decision-making study http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf

10. **IOSCO Publishes results of the third annual Risk Outlook Survey**
See page 22-24 of the report, in particular, which includes the risks in the area of investor protection with a section of Financial Risk Disclosure stating: "An overwhelming majority of respondents reported that inadequate disclosure of financial risks puts investors at risk of buying products or services that are much riskier than individual investors may be comfortable with. As such, there could be a mis-match between the risk appropriate of the investor and the risk embedded in the product."Risk Outlook Survey: Detailed methodology and results 2015,

OTHER REFERENCES

Volatility Inadaptability: Investors Care About Risk, but Cannot Cope with Volatility
ABSTRACT : This article investigates two research questions: do investors see a relationship between risk attitude and the amount invested into risky assets? Further, do investors adjust their investments if provided with assets that have different volatilities? In an experimental study, investors allocate an amount between a risky and a risk-free asset. Investors' risk attitude predicts risk taking. Investors are, however, unable to adapt to risky assets with different volatilities; they choose almost the same allocation to the risky asset independently of its volatility, thus amassing significantly different portfolios. http://rof.oxfordjournals.org/content/18/4/1387.abstract

Communicating Risks and Benefits: An Evidence-Based User's Guide
http://www.fda.gov/downloads/AboutFDA/ReportsManualsForms/Reports/UCM268069.pdf

Mutual Fund Cost of Ownership Investor Economics
https://www.ific.ca/wp-content/uploads/2013/08/Canadian-Study-Mutual-Fund-MERs-and-Cost-to-Customer-in-Canada-September-2012.pdf/1655/ " In the case of mutual fund holders who pay either a one-time sales commission at the time of purchase of

front-end load mutual fund units or a one-time deferred sales charge on the redemption of back-end load mutual fund units, we have conservatively assumed an average holding period of 4.5 years...” and “ Reflecting the growing importance of pre-assembled solutions, fund wraps have captured nearly 80 cents of each dollar flowing into the mutual funds industry between 2007 and 2011. **Figure 30** monitors the growing importance of fund wraps to the fund industry’s book of business...”

Risk Revisited Again One of the best plain language explanations of the many facets of investing we have ever seen is Howard Marks of Oaktree Capital's **Risk Revisited Again** . It is well worth a read.

William Bernstein on the Definition of Risk - A Wealth of Common Sense
http://awealthofcommonsense.com/william-bernstein-risk/

ICI Comment Letter on NASDR Release on Bond Fund Risk Ratings :ICI
https://www.ici.org/policy/comments/97_NASD_VOLATILITY_RTGS_COM

Fees impact Bond fund risk & return « The Wealth Steward
http://thewealthsteward.com/2010/08/fees-impact-bond-risk-return/
"....Two observations. First, the MER reduces the yield-to-maturity by slightly more than the stated level. This is due to the compounding impact of fund fees, which are typically charged daily and paid monthly. Second, fees also nudge duration up because they increase the length of time before the purchase price of the bond is recouped. In other words, fees slightly increase duration risk while also slicing into returns. The result is a double-whammy impact on our risk-return ratio....".

Management Expense Ratios (MER) influence return distribution
http://retirehappy.ca/management-expense-ratios-do-matter/ Respected blogger Jim Yih looked at the impact of actively- managed mutual fund fees for 4 major fund categories . He found" *Fees matter more over longer time frames.* When you look at 5 and 10 year returns, there is a greater correlation that funds with lower MERs have on average better performance. For example, if we look at the 25 funds with the lowest MERs and compare them to the 25 funds with the highest MERs, the returns on a 5 year basis were on average 50% higher. Over a 10-year period, funds with low MERs performed 25% better than funds with high MERs...." .Thus ,over the long term the risk of underperforming a benchmark increases due to fees ; the amount of underperformance is material. During a market downturn ,the risk of losing money will be greater with high fee funds compared to lower cost counterparts.

Investors don’t understand the risks of physical ETFs | Canadian Investment Review
http://www.investmentreview.com/expert-opinion/investors-dont-understand-the-risks-of-physical-etfs-5810

Risk assessment Moneymanagedproperly blog http://moneymanagedproperly.com/Education%20Investor/Risk%20assessment.pdf

Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* ("NI 81-101"), Form 81-101F3 and Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* and Consequential Amendments
http://www.cfasociety.org/cac/Comment%20Letters/2012/CSA%20NI%2081-101%20Mutual%20Fund%20Prospectus.pdf

Is Your Bond Fund's Rating a Lie? - CBS News
http://www.cbsnews.com/news/is-your-bond-funds-rating-a-lie/

Do Investors Care about Risk? Evidence from Mutual Fund Flows
Abstract: Using an extensive database compiled from SEC N-SAR filings, we study how risk affects monthly flows to equity mutual funds over the period 1996 to 2009. Unlike most previous studies, we separately examine inflows, outflows, and net flows. We find that both retail and institutional investor inflows and outflows strongly chase past raw performance, but more importantly, they do so without regard to risk. This behavior appears to neither help nor harm investors, but it has significant implications for fund managers. Among other things, the well documented inability of fund managers to produce significant abnormal returns may be due to incentives rather than lack of skill or market efficiency.
http://www.ou.edu/dam/price/Finance/Oklahoma_conference/2011/Chris%20Clifford%20-%20Do%20Investors%20Care%20about%20Risk.pdf

THE RISK PERCEPTIONS OF INDIVIDUAL INVESTORS
For those investors who systematically perceive risk according to the same risk measure, semi-variance of returns is most popular. Semi-variance is similar to variance, but only negative deviations fro the mean or another benchmark are taken into account. Stock investors implicitly choose for semi-variance as a risk measure, while bond investors favor probability of loss.
https://dspace.stir.ac.uk/bitstream/1893/335/1/the-risk-perceptions-of-individual-investors-revision-may30.pdf

Point of Sale Disclosure and Regulatory Failure in Canadian Retail Financial Services: Tamris Consultancy
No one wants to tell investors that this is a transaction relationship. As far as we are concerned this is misrepresentation at the highest level.http://www.moneymanagedproperly.com/technical%20docs/Point%20of%20Sale%20and%20Regulatory%20Failure%20September%202010.pdf P34 - POS – a communication outside of a suitability process: The Point of Sale document is a regulatory mandated communication between a product provider and the client and not a communication between the client and the advisor. As such it really lies outside the suitability process and therefore cannot be confirmation, on its own, of the suitability of the recommendation.

Volatility and Mutual Fund Manager Skill by Bradford D. Jordan, Timothy B. Riley :: SSRN

ABSTRACT Low volatility mutual funds outperform high volatility funds to a remarkable degree, and, in a standard four factor framework, past volatility is a reliable, persistent, and powerful predictor of future abnormal returns. Analyses patterned after Kosowski, Timmerman, Wermers, and White (2006) and Fama and French (2010) indicate that low volatility fund managers have significant skill. However, the addition of a factor contrasting returns on diversified portfolios of low and high volatility stocks eliminates differences in risk-adjusted performance. We conclude that either our volatility measure is associated with a pervasive, systematic pricing factor, or else the volatility effect is a market inefficiency of extraordinary size. Either way, failure to account for the volatility effect can lead to substantial mismeasurement of fund manager skill. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365416&download=yes

Junk Fund's Demise Fuels Concern Over Bond Rout - WSJ

A firm founded by legendary vulture investor Martin Whitman is barring investor withdrawals while it liquidates its high-yield bond fund, an unusual move that highlights the severity of the months long junk-bond plunge that has swept Wall Street. The decision by Third Avenue Management LLC means investors in the $789 million Third Avenue Focused Credit Fund may not receive all their money back for months, if not more. Third Avenue said poor bond-market trading conditions made it almost impossible to raise sufficient cash to meet redemption demands from investors without resorting to fire sales of assets. http://www.wsj.com/articles/as-high-yield-debt-reels-mutual-fund-blocks-holders-from-redeeming-1449767526

Management Expense Ratios (MER) influence return distribution

http://retirehappy.ca/management-expense-ratios-do-matter/ Respected blogger Jim Yih looked at the impact of actively- managed mutual fund fees for 4 major fund categories . He found" *Fees matter more over longer time frames.* When you look at 5 and 10 year returns, there is a greater correlation that funds with lower MERs have on average better performance. For example, if we look at the 25 funds with the lowest MERs and compare them to the 25 funds with the highest MERs, the returns on a 5 year basis were on average 50% higher. Over a 10-year period, funds with low MERs performed 25% better than funds with high MERs...." .Thus ,over the long term the risk of underperforming a benchmark increases due to fees ; the amount of underperformance is material. During a market downturn ,the risk of losing money will be greater with high fee funds compared to lower cost counterparts.

Risk-assessment tools inadequate, study finds

http://www.investmentexecutive.com/-/risk-assessment-tools-inadequate-study-finds

While the focus group testing done by the CSA indicated that investors had difficulty understanding the principal risks that were described in the section, we are of the firm conviction that the principal risks need to be disclosed on FF; a way to present this info needs to be found in a manner that would alert investors to the other risks involved with fund ownership. To tell them to go to the Simplified Prospectus is simply not adequate.

INCLUDES COMMENT LETTERS

NOTE: The IOSCO document (see Appendix) on page 20 states *"However focus groups alone may not be the most effective way to test the usability of a document or to learn how well an individual really understands what is written."*

Vanguard Principle 3: Minimize cost Impact of costs on return and risk of loss
https://personal.vanguard.com/us/insights/investingtruths/investing-truth-about-cost A powerful
presentation on how fees impact return profile and risk.

Mutual Fund Risk Classification Methodology - a modest proposal
Respected fund blogger Jean Lesperance proposes MER fee bands as a good indicator of fund risk. He points out that "Regulators are looking for a methodology to stick a label on mutual funds that tells ordinary Joe investors how much risk they are taking on if they buy into the fund. The regulators want something that is easy to understand, easy to calculate and implement, stable through time, easy to monitor and uniformly applicable to all types of funds. The proposal is to use monthly volatility over the last ten years, expressed annualized, either of the fund itself if it has enough history, or its benchmark index to make a five level Low to High risk scale but is surprised that - **the ability of the risk measure to predict the chance and the size of potential loss** is curiously missing. Unlike temporary market volatility, MER money is gone, permanently lost to the investor, it's withdrawn every year. Interesting thought.

Should Canada's Financial Advisors Be Held to a Fiduciary Standard? , January 30, 2015 "While Canada's regulators have proposed a number of regulatory reforms to better serve the public trust, well-entrenched conflicts of interest will continue to impact the quality of advice that consumers receive. Despite potential challenges in its implementation, holding financial advisors to a fiduciary standard represents one of the most important steps Canadian regulators can take to ensure that the advice consumers receive is truly in their best interests. "
http://dtpr.lib.athabascau.ca/action/download.php?filename=mba-15/open/punkon-aprj-final.pdf

Risk literacy: Italian research
http://gflec.org/wp-content/uploads/2015/03/Risk-Literacy-Ital-Econ-J-2015.pdf

Fooled-by-Randomness-Investor-Perception-of-Fund-Manager-Skill.
http://www.evidenceinvestor.co.uk/wp-content/uploads/2015/08/Fooled-by-Randomness-Investor-Perception-of-Fund-Manager-Skill.pdf

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https://www.lautorite.qc.ca/files/pdf/fonds-education-saine-gouvernance/finances-perso/fin-perso_ulaval_knowledge-rationality.pdf

The Canadian Money State of Mind Risk Survey 2014: Investor Risk, Behaviour & Beliefs | Our research | GetSmarterAboutMoney.ca

Almost one-quarter of individuals who identify themselves as low-risk investors own "medium- to very high-risk" products; conversely, seven in 10 self-identified high-risk investors own "low- to medium-risk" products. One-in-three Canadian investors had a major loss (at least 20 per cent of their investment value) in one year. Of those who had a major loss, 51 per cent stayed the course and didn't change their investments in response. Just over half of investors have regretted an investment decision based on emotion, although most have done so only once or twice.
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/Investor-Risk-Behaviours-and-Beliefs-2014.aspx#.VnAiIq_EirU

Risk and a Investor Behaviour
http://www.investmentreview.com/files/2009/12/Risk_Kalirai1.pdf

What's wrong with multiplying by the square root of 12?
http://corporate.morningstar.com/US/documents/MethodologyDocuments/MethodologyPapers/SquareRootofTwelve.pdf

Risk Profiling - Urgent Need for Risk Appetite Testing
http://riskprofiling.com/blog/November-2015/needreliablerisk

Investment risk and financial advice: Vanguard
https://www.vanguard.co.uk/documents/adv/literature/investor-risk-profiling.pdf

Canadian Association of Retired Persons - Submission on financial advice and Planning
Canadians' investment and financial literacy is very low. A recent study of Quebec and Ontario investors' knowledge found that there are "significant gaps" in investor knowledge of risk and return of asset categories, and that the general level of investor knowledge is "mediocre."**viii** The study notes that this "mediocre knowledge of the performance of categories and of the concept of risk premium calls into question investors' financial planning ability."**ix** Investors fail to understand a number of significant aspects of sound financial investment, according to the findings of the study:**x**
http://www.fin.gov.on.ca/en/consultations/rfp-submissions/canadian-retired.html

Measuring Investors' Risk Appetite http://papers.ssrn.com/sol3/papers.cfm?abstract_id=872695

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http://www.ey.com/Publication/vwLUAssets/EY-risk-profiling-consumer-protection-agenda-investment-suitability/$File/EY-risk-profiling-consumer-protection-agenda-investment-suitability.pdf

The Costs and Benefits of Financial Advice
http://www.hbs.edu/faculty/conferences/2013-household-behavior-risky-asset-mkts/Documents/Costs-and-Benefits-of-Financial-Advice_Foerster-Linnainmaa-Melzer-Previtero.pdf
Stephen Foerster, Juhani Linnainmaa, Brian Melzer Alessandro Previtero ,March 8, 2014
Abstract :We assess the value that financial advisors provide to clients using a unique panel dataset on the Canadian financial advisory industry. We find that advisors influence investors' trading choices, but they do not add value through their investment recommendations when judged relative to passive investment benchmarks. The value-weighted client portfolio lags passive benchmarks by more than 2.5% per year net of fees, and even the best performing advisors failto produce returns that reliably cover their fees. We show that differences in clients' financial knowledge cannot account for the cross-sectional variation in fees, which implies that lack of financial sophistication is not the driving force behind the high fees. Advisors do, however, influence client savings behavior, risky asset holdings, and trading activity, which suggests that benefits related to financial planning may account for investors' willingness to accept high fees on investment advice.

December 15 , 2015

Kivenko Comment Letter

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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Financial and Consumers Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

I have worked in close contact with a number of professional advisors for several years. These are advisors that work to a Best interests standard and have professional credentials like CFP/CFA. All have at least 10 years experience.

I reached out to them re the current consultation regarding mutual fund risk rating.

Virtually all of them provided me similar feedback. Kenmar are submitting a representative commentary on one individual's behalf (with his permission) because dealer representatives are discouraged / prohibited by their firms to make submissions directly to regulators.

Unfortunately ,regulators do not seek direct input either.

As a result , I am filing on their behalf .In doing so , I am giving them a voice.

Here is the Commentary from one individual that represents the consensus view :

In my meetings with investors and discussing Fund Facts with investors, I hesitate when I get to the risk classification section.100% of investors that I meet with assume the risk section means " the risk of losing one's capital." Even many advisors, still assume the risk section is equivalent to the prospectus definition of the fund's investment objectives where the fund manager generally describes the "riskiness" of the fund or perhaps generically suggests what type of investors the fund is appropriate for.

My understanding of the current Fund Facts risk scale is purely mathematically based using standard deviation which is a statistical measure of "ups" and "downs" of investment fund prices over a period of time. Standard deviation is really a measure of fluctuation and by definition is a measurement of the risk of a fund moving up in value (or down). Investors, generally are not primarily concerned with the risk of up markets or upward moving investment funds so the use of standard deviation as a measurement of risk may not be entirely appropriate. Conversely, although it sounds like a cliché these days, we all have heard of the ideal low risk, low standard deviation investment fund that smoothly declines to zero.

And that is one of the inherent flaws of using measurements of up/down fluctuations. For instance we have had several years of abnormally quiet stock markets and standard deviations(by their very nature) have come down in value. I do see a trend where even pure equity funds are starting to appear below the medium risk category. No fluctuation = no risk. Although these statistical measurements are empirically correct, they can lull investors and perhaps some advisors too, into a false sense of security where pure equity funds appear to be lower risk investments. As I approach three decades experience in this business, I can assure everyone that stocks, equities and equity mutual funds are not low risk investments.

We know from history that things can change very, very quickly. The low standard deviation which measures today as a low medium can be a high medium in short order. Some dealer's only have three categories; low, medium, high. A medium high classification does not exist at many dealers and would be forced automatically in to the "high" category triggering compliance off -sides where a client's stated medium risk category now has high risk funds. Compliance departments are required to tell advisors to get back onside. This puts advisors in the precarious position of molding a clients risk levels to the product which should never be done. Additionally, if the advisor is forced to sell the "high risk" investment which really might be one notch over"medium", there could be serious tax consequences to the investor to do so.

Although lengthening the measurement time to 10 years might help a little, I think we are missing the obvious here. When I have a discussion of risk with an investor regarding a pure equity fund, I speak in terms of maximum drawdown; i.e. Are you aware that the index dropped -57% between October 2007 and March 2009? and this medium-low fund only dropped -47%? during that same time frame. This where the rubber meets the road in determining risk tolerance.

Therefore, a classification of a "low-medium" Fund Facts classification will not properly convey the idea of "risk' when an investor is considering to purchase a mutual fund.

I would highly recommend that regulators use maximum drawdown numbers over longer periods to convey the true meaning of downside risk that investors can readily understand.

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.Yours truly,
Ken Kivenko P.Eng. (on behalf of a advisor)