PortfolioAid

Via Email

February 20th, 2014

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
consultation-en-cours@lautorite.qc.ca
-and-
The Secretary
Ontario Securities Commission
comments@osc.gov.on.ca

Re: **CSA Notice 81-324 Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts**

We are writing on behalf of Portfolio Aid Inc., a provider of intelligent compliance solutions for the financial services industry in Canada. Our solution is used by leading Canadian advisory dealers for governance, risk, and compliance management. We appreciate the opportunity to provide comments on the CSA proposal.

**General Comments**

Overall, we agree with the purpose of the proposal brought forth by the CSA. We feel that a standardised approach to risk rating methodology is needed in the financial services industry, particularly so in the investment fund sector. Furthermore, we feel the proposal will offer the investing public greater transparency in the selection of appropriate investment products for their investment portfolios. For these reasons we would support the option presented in the proposal for the mandatory inclusion of a standardised risk classification as part of the fund facts documentation.

**Specific Comments**

Firstly, we would like to suggest that any standardised risk rating be accompanied with appropriate language that informs the investing public that the risk classification is not a guarantee of future performance. While the proposal speaks of including similar language, our concern is that the public misconstrue the risk rating as being the sole factor necessary in evaluating the appropriateness of an investment in an investment fund. We feel that the language be strengthened to indicate that there are many considerations beyond the risk rating to be evaluated before any investment is made. We appreciate that the intent of the fund-facts document to be written in plain language and accessible to the broad investing public; we are concerned that the significance of the risk rating may be overstated or misrepresented.

Furthermore, we would recommend that as part of any accompanying guidance note issued by the CSA, that it make clear to industry participants that the risk classification is merely one dimension to be considered as part of a Know-Your-Product (KYP) and Know-Your-Client (KYC) suitability assessment. We feel that the risk classification could be misused by industry participants as a short-cut replacement for a proper KYC suitability assessment.

Secondly, we feel that the strength of a unified standard in risk classification requires the proposal to be mandated for inclusion as part of the fund facts documentation. We do feel however that an investment fund manager or investment fund distributor should have the option of indicating a more conservative rating than what the standard deviation testing would indicate. We feel that certain investment strategies present themselves with unique risk considerations that may not present themselves in standard deviation testing.

For example, consider a mutual fund that owns a portfolio of foreign government bonds. As disclosed in the mutual fund prospectus, the investment fund manager may have discretion to hedge currency risk as needed. The standard deviation for this portfolio may be quite low, thus indicating a "low" or "low to medium" risk classification. If previously the portfolio manager had hedged the currency risk exposure, and for whatever reason has since discontinued the hedging practice, the risk of a currency fluctuation may now be greater than would be represented as part of the risk classification methodology. We feel it would be beneficial for an investment fund distributor or investment fund manager to elect a higher risk classification than what the standard deviation tests indicate. We do not feel it appropriate to be able to select a lower risk classification for any reason.

Thirdly, we have significant concerns about the use of a historical synthetic proxy reference index for investment funds that have not been in existence for the full 10 year term. Correlated to this point, we are also concerned with the proper procedure to undertake during a merger of investment funds.

Our concerns with the proxy reference index are such that very few funds have 10 years of historical data. The funds that do have such data exhibit strong evidence of survivor bias, being that it is unlikely that a fund with inferior performance would remain under offer for a full 10 year period. Thus, funds with a 10 year track record will exhibit superior performance. Replicating a reference index that demonstrates a superior performance aspect of investment funds without a 10 year track record is an opportune place for misrepresentation from unscrupulous investment fund managers.

The proposal discusses using a proxy reference index with the following criteria:

" • have returns highly correlated to the returns of the mutual fund;

• contain a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations; and

• have a historical systemic risk profile highly similar to the mutual fund. "

In our view, these guidelines need to be strengthened. The opportunity is too great to use a proxy reference index that misconstrues the historical volatility of the fund. Particularly, if the proxy index contributes significantly to the softening of volatility in comparison to the actual fund volatility. In our view, there should be a maximum threshold that the proxy reference index can contribute to a reduction of standard deviation and consequently the risk classification measurement. This is of particular significance for newer investment funds that would rely on the proxy index for the majority of the data points used in the risk categorisation.

Similarly, we feel that in a fund merger situation, there needs to be clear rules surrounding the use of historical returns, particularly if the funds are from distinctly different asset classes or investment strategies. It may be beneficial to set a maximum threshold that a merger can diminish the risk classification rating on the newly merged investment fund.

Furthermore, we feel that the proposal needs greater guidance on a risk rating that is near the boundary, or at the boundary between two classifications. The proposed thresholds allow for a fund that has a standard deviation of 6% to be either rated as 'Low-to-Medium' or 'Medium'. The guidance should be strengthened to address these boundary issues.

We also feel that the fund facts document should demonstrate to the investor that a risk rating has been changed within a specified number of years. We feel that the inclusion of the trend of risk rating be a useful measure for the investing public, particularly so if the risk rating is decreasing in Standard Deviation terms.

**Concluding Remarks**

As per our comments above, we support the CSA proposal in principle. Our view is that the goals of a uniform methodology that is easily understood and meaningful to participants is worthwhile. We fully support the mandatory nature of this disclosure. Our view is to support greater transparency within the investment industry generally. The proposed risk classification measure is a useful contributing element to a robust KYC and KYP assessment by participants and the investing public alike.

We wish to extend our thanks for the opportunity to provide our comments on the proposed notice. We would welcome any opportunity to discuss the foregoing with you in further detail. Should you have any questions that require more information from PortfolioAid, please do not hesitate to contact the undersigned.

Sincerely,

"Sam Webster"

President and CEO

Portfolio Aid Inc.

"Christopher Shultz"

Director – Strategic Alliances

Portfolio Aid Inc.