Via email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

March 10, 2014

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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

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

Dear Sirs/Mesdames:

Re: CSA Notice 81-324 and Request for Comment – Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts

This comment letter is being submitted on behalf of the following entities within RBC: RBC Global Asset Management Inc.; RBC Dominion Securities Inc.; Royal Mutual Funds Inc.; and Phillips, Hager & North Investment Funds Ltd. We appreciate the opportunity to provide feedback and discuss the proposed mutual fund risk classification methodology ("Proposed Methodology") as outlined in the Canadian Securities Administrators' ("CSA") request for comment on CSA Notice 81-324 – Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts dated December 12, 2013 ("Notice"). We agree that this is a very important initiative for the CSA, the mutual fund industry and investors.

GENERAL COMMENTS AND RECOMMENDATIONS

1. We agree with the intent of the Proposed Methodology, which is to improve consistency in how fund risk is assessed by Fund Companies, enhance comparability of risk ratings across Funds, and enhance transparency for how risk ratings are assigned.

- We also agree with the objectives for establishing the methodology as outlined in the Notice, including that the methodology be uniform and applicable to all funds; easy to understand; meaningful and comparable across funds; difficult to manipulate and minimize subjectivity; relatively simple and cost effective to implement; enable easy and effective regulatory supervision; and be a stable indicator of risk over time.

- Approached thoughtfully, we have an opportunity to improve investor understanding of investment risk, enable better decisions by investors and improve investment outcomes.

2. Simplicity is a good objective, however being too simplistic will not improve investor understanding of risk.

- We remain concerned with over-simplifying mutual fund risk to a single, qualitative risk rating. We are also concerned that investors/advisors become overly reliant on fund risk ratings for the purpose of fund selection and portfolio construction.

- Categorizing mutual funds into one of six (or five) qualitative descriptors will not improve an investors' understanding of risk. In fact, it remains less transparent in the assessment of risk and client suitability.

- We agree with the intent of the current proposal, but it is potentially very disruptive to investors and dealers without going far enough to improve the level and quality of information available to investors.

- There was no indication in the Notice that the CSA views the current industry standard methodology as insufficient or that it understates fund risk. If the Proposed Methodology is implemented, a significant number of funds will be re-labeled as higher risk despite no change in the actual underlying volatility of these funds. It is anticipated that RBC GAM would be required to increase the risk rating on more than half of the 160 prospectus qualified funds under our management.

3. Impact on dealers and investors will be significant.

- Many dealers apply the MFDA's suitability methodology that makes a direct link between clients' risk tolerance as stated on their KYC with the risk rating disclosed in the prospectus for the mutual funds they hold. Changing the risk label for a significant number of funds will likely result in funds that are currently suitable for a client's portfolio no longer being suitable for the investor under MFDA rules. This would result in the need for client account reviews, repapering client accounts and/or changes to client portfolio allocations.

- The impact of wide scale risk band adjustments cannot be overstated. We ask whether the CSA objectives of consistency, comparability and transparency could be met without having to reclassify a large number of funds across the industry.

- We acknowledge the CSA's view that the initial risk reclassification "should not generally be interpreted as meaning that the fund has a greater degree of risk than was previously the case". However, this will be very confusing to clients and salespeople. More clarity is needed on the intended impact of the risk adjustments on the assessment of client and product suitability, both initially and on an ongoing basis.

4. **Providing better information to investors will enable better decisions and improve investment outcomes.**

- Investment outcomes are often challenged by investors that do not understand the risks associated with their investment decisions. Outcomes are challenged by investors reacting to short term events despite longer term investment objectives.

- Standard deviation is a good comparator, however we suggest that no single measure is sufficient to adequately improve investors understanding of investment risk.

- When asked about risk, many investors indicate their greatest concern is risk of loss of capital.

- Disclosing both standard deviation and a historical risk of loss will enable better understanding, enable better comparisons and provide more context to help manage investors' expectations.

Key Recommendations

1. We agree with the use of standard deviation as a comparable measure of risk.

2. We recommend describing standard deviation as 'the variability of returns' rather than simply as risk. We suggest providing additional language to clarify its definition. For example, 'standard deviation measures the amount of variability of returns that has historically occurred relative to the average return. The higher the standard deviation of a fund, the greater the range of returns it has experienced in the past'.

3. We recommend the use of a numeric scale to disclose both the current 10-year standard deviation and the prior year 10-year standard deviation.

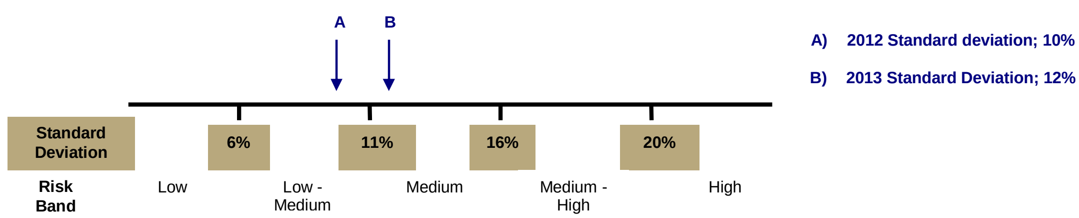
    a. Disclosing the current and prior year figures would inform investors of the size of change in standard deviation rather than only reporting a qualitative change (or no change at all if the standard deviation remains within the same defined risk band).

    b. Limiting disclosure to a qualitative risk band limits the information available to investors.

    c. A numerical scale would also improve the comparability across mutual funds and enable easy independent verification.

    d. Disclosing actual data does not detract from the CSA's objectives.

    e. In the example below, an investor would know that standard deviation was 2% higher year over year. Additionally, comparing a Fund with a standard deviation of 11% to another Fund with a standard deviation of 16.0% is more informative than comparing two Funds that are both labelled Medium risk (as per the Proposed Methodology).



4. We recognize that dealers may still require a qualitative risk descriptor for suitability assessments.

   a. A qualitative risk descriptor is necessary for client suitability assessments, but is not sufficient for investors to understand product risk.

   b. We suggest that the qualitative descriptor be made available, but not be the driver for reporting material changes. We recommend that fund companies be required to update standard deviation on an annual basis in conjunction with Fund Facts renewal, and report current and prior year calculations.

5. We recommend supplementing disclosure of volatility with a historical risk of capital loss.

   a. We believe it would be meaningful to investors to disclose the downside risk – the worst and best 3-month, 1-year, 3-year, 5-year and 10-year returns for a relevant benchmark going back to a defined date beyond the most recent 10-year period.

   b. The most recent 10-year period may not accurately reflect the potential for loss, if it were in the midst of a stable or bull market.

   c. While not fund specific, this disclosure would provide clients with greater context in assessing the general risk of their investment.

   d. The broad-based benchmark should be the benchmark disclosed in the Fund's Management Report of Fund Performance. Alternatively, Canadian Investment Funds Standards Committee ("CIFSC") and the CSA could agree to broad-based benchmarks assigned to each CIFSC fund category.

6. We recommend adopting a staged approach to the CSA proposal.

   a. The first phase would mandate the CSA Proposed Methodology using the existing Fund Facts risk categories and breakpoints. The first phase would be relatively simple and cost effective to implement, and achieves the three main objectives of this proposal.

      In addition we would recommend the first phase include the additional disclosure outlined in recommendations above.

   b. If the CSA plans to amend the number of risk categories and breakpoints, we recommend a second phase that involves a thorough assessment of the objective, rationale, impact and benefits for the proposed changes.

      We ask the CSA to provide specific guidance to the Self-Regulatory Organizations ("SROs") regarding how dealers will assess suitability after the risk reclassification.

      Further, we strongly recommend that SROs publish guidance along side 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. This would give the CSA and SROs time to consider whether moving to six risk categories would be beneficial and how to effectively implement such a change to minimize impacts to clients and the mutual fund industry.

ISSUES FOR COMMENT IN THE NOTICE AND REQUEST FOR COMMENT

1. As a threshold question, should the CSA proceed with (i) mandating the Proposed Methodology or (ii) adopting the Proposed Methodology only as guidance for fund managers 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 Proposed Methodology, or by adopting it only as guidance? We request feedback from investment fund managers and dealers on what a reasonable transition period would be for this.

If the methodology is suitable and appropriate, we support a mandated approach.

We believe that the CSA can achieve the same objectives by mandating the Proposed Methodology for calculating standard deviation while using the existing Fund Facts risk categories and breakpoints. This would enable a shorter transition period, potentially as early as end of 2014.

With respect to a reasonable transition period, we strongly encourage the CSA to consider the implications of "re-risking" the mutual fund continuum and the subsequent changes it would have on the mutual fund suitability assessments conducted by dealers for their clients. As previously noted, we strongly recommend that SROs publish guidance along side proposed consequential rule changes.

2. We seek feedback on whether the Proposed Methodology 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 Proposed Methodology? For instance should standard deviation be calculated with returns based on market price or net asset value per unit?

We believe that a common methodology could be used for other solutions, including ETFs. We would encourage the use of market price for ETFs given that this best reflects the investor experience.

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 Proposed Methodology.

We agree with the benefits of having a standardized methodology.

The cost incurred by fund managers is not expected to be significant. We ask the CSA to reconsider the requirement for monthly monitoring for risk rating changes for the following reasons: 1) the CSA analysis highlighted the stability of the 10-year standard deviation calculation over time; and 2) more than 60% of mutual funds currently have a shorter performance history than 10 years, therefore, the majority of funds will be reporting standard deviations that blend fund and index performance. Including the actual current year and prior year standard deviation would highlight actual changes for investors. We recommend annual updates to the risk ratings contained in the Fund Facts.

The cost incurred by dealers would depend on guidance from the CSA and the SROs' implementation strategy, and the intended impact on the client and product suitability assessment conducted by dealers. These costs could be significant if the risk categories and risk band breakpoints are changed, as dealers would have to amend processes and systems technology to accommodate the changes. Additionally, change in the risk classification of a Fund would require dealers to conduct client account reviews, repaper client accounts and/or change client portfolio allocations. As indicated earlier, it is difficult to comment on the cost of implementation of the Proposed Methodology without any details of the initial and ongoing application to dealers.

4. We do not currently propose to allow fund managers discretion to override the quantitative calculation for risk classification purposes. Do you agree with this approach? Should we allow discretion for fund managers to move their risk classification higher only?

We agree that fund managers should not be allowed to override the quantitative calculation for risk classification purposes. We also agree that if only qualitative descriptors are used, the CSA should allow fund managers discretion to move their risk classification higher.

We suggest that including the actual standard deviation figure in Fund Facts potentially eliminates the need for overrides because a factual number is disclosed that investors can equate to the risk classification scale.

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.

Yes, we recommend including the current and prior year 10-year standard deviation and a risk of loss measure in the disclosure. Please see recommendations on page 3 and 4.

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.

We agree that a uniform measure should be applied across all investment funds.

7. We understand that it is industry practice (for investment fund managers 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 frequency would improve fund risk disclosure and be of benefit to investors. Please supplement your recommendations with data/analysis wherever possible.

We agree with the use of monthly returns to calculate standard deviation.

We believe that investor understanding of risk would be improved by adding risk of loss disclosure. The use of a broad-based benchmark (standard history, since inception) would provide sufficient information and address the biases inherent in funds having different inception dates and the recency effect of only using the most recent 10-year period.

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.

We agree with the proposed 10 year period as the basis for comparison of standard deviation across funds.

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. While a rolling 10-year measurement period will not significantly impact the standard deviation calculation, it would 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 1960).

S&P 500
Total Returns (US$)

	Worst		Best	
	Period Ending	**Compounded Annual Return***	**Period Ending**	**Compounded Annual Return***
1 mo	Oct-87	-21.5%	Oct-74	16.6%
3 mo	Nov-08	-29.6%	Oct-82	26.7%
6 mo	Feb-09	-41.8%	Jun-75	41.8%
1 yr	Feb-09	-43.3%	Jun-83	61.0%
3 yr	Mar-03	-16.1%	Jul-87	33.4%
5 yr	Feb-09	-6.6%	Jul-87	29.7%
10 yr	Feb-09	-3.4%	Aug-00	19.5%
15 yr	Jun-12	4.8%	Jul-97	19.7%
20 yr	Mar-82	6.5%	Mar-00	18.3%

*Periods 1 year and less are simple returns.
Note: Total return data from 1960 onwards

By contrast, if a single rolling 10-year period were used, the previous 10-year period may not accurately reflect the potential for loss. The worst annual loss for the S&P500 (since 1960) was -43.3%. In 2000, the S&P500 would have reported its worst annual loss of -3% over the previous 10-years.

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.

We agree that a consistent approach should be applied across all series/class.

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.

We suggest that the reference index be consistent with the broad-based market index chosen for the Management Report of Fund Performance.

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.

i) We ask that the CSA carefully consider the implications of any changes to the number of risk bands and the risk band break-points. The objectives and principles outlined by the CSA will be achieved by employing the Proposed Methodology and using the risk bands and break-points currently used in Fund Facts.

ii) Establishing risk bands and break-points is extremely subjective. We note that under the Proposed Methodology, the majority of mutual funds would be labeled “Medium-to-High”. Given the range of investment options, it is not intuitive that broad-based equity funds, which exhibit risk levels similar to broad equity markets be considered “Medium-to-High” volatility.

The addition of a “very aggressive” category for mutual funds seems unwarranted, especially considering that mutual funds, even higher risk sector funds, hold a basket of securities which tends to reduce risk over time. Investments in a single stock, a leveraged investment, or shorting stocks should be considered more risky than a “very aggressive” mutual fund.

We suggest that including a numeric continuum and disclosing current and prior year standard deviation along with the current risk bands and risk band break-points provides investors with additional relevant information and limits the potential concerns with re-risking the mutual fund continuum.

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.

We do have concerns about the frequency of the monitoring process and the potential for changing risk-bands, which are arbitrary points on the continuum. We recognize that the back testing analysis conducted by OSC staff indicates stability in the trailing 10-year standard deviation. However, changing risk ratings will be disruptive for clients, dealers and fund managers. In addition, the absolute requirement to change risk ratings will not consistently reflect the magnitude of the change.

We suggest that including a numeric continuum and disclosing current and prior year standard deviation along with the current risk bands and risk band break-points provides investors with additional relevant information and limits the potential concerns with re-risking the mutual fund continuum. Given the CSA’s assessment of stability of the 10-year standard deviation, we suggest annual adjustments to Fund Facts disclosure would be sufficient.

13. Is a 10 year record retention period too long? If yes, what period would you suggest instead and why?

We agree records must be kept for validation and verification purposes. RBC enterprise retention policy for record keeping is seven years. We are cognizant that different fund managers may have different record retention policies.

14. Please comment on any transition issues that you think might arise as a result of risk classification changes that are likely to occur upon the initial application of the Proposed Methodology. How would fund managers and dealers propose to minimize the impact of these issues?

As outlined above, the key issue with respect to the initial application of the Proposed Methodology is the potential reclassification of a large number of funds (fixed income funds in particular) due to the "re-risking" of the mutual fund continuum. While it is indicated that the initial risk band adjustments would not be treated as an increase in degree of risk, it is difficult to envision a sustainable treatment of 'grandfathered' holdings. Given the potentially significant magnitude of the impact on dealers and investors, we ask whether the CSA objectives of consistency, comparability and transparency could be achieved without a reclassification of a large number of funds across the industry.

For example, dealers conduct assessments on the suitability of mutual funds for their clients based on the information provided by the fund managers. One key piece of such information is the risk rating of the funds. With the expansion to six risk categories, some funds will need to be reclassified. Dealers may then need to update client documentation to reflect these changes, and educate clients about the regulatory change. As well, supervisory and trade surveillance systems would need to be updated to accommodate six risk bands. Internal processes and systems technology would also have to be amended.

Another issue is the re-filing and/or 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. We encourage the CSA to consider the next filing of annual renewal of regulatory documents as a window for implementation of a risk rating change.

To minimize these issues, we encourage the CSA to consider adopting the Proposed Methodology with the existing risk bands and break-points. If the CSA proceeds with revising the risk bands and break-points, we recommend the CSA adopt a staged approach to implementation, provide additional guidance regarding reclassification, and work closely with the SROs and dealers on the analyzing the potential impact of the Proposed Methodology and intended implications on dealers and investors. Reasonable timelines should be communicated and established with fund managers and dealers to ensure compliance.

Sincerely,

"David Agnew"

Chief Executive Officer
RBC Dominion Securities Inc. (Retail)

"Douglas Coulter"

President
RBC Global Asset Management Inc.

"Wayne Bossert"

Chief Executive Officer and President
Royal Mutual Funds Inc.

"Mark Neill"

President
Philips Hager & North Investment Funds Ltd.