March 12, 2014

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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 Territory
Superintendent of Securities, Nunavut

The Secretary
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Dear Sirs/Mesdames:

We are writing this letter on behalf of the Canadian Exchange-Traded Fund Association ("**CETFA**"). Based in Toronto, CETFA is the only exchange-traded fund ("**ETF**") association in Canada, representing two-thirds of the companies offering ETFs.

CETFA appreciates the opportunity to provide comments on the CSA Discussion Paper and Request for Comment 81-324 *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the "**Consultation Paper**").

While many of our members have multiple lines of business – the views presented here are from the standpoint of their ETF businesses.

Overall we are in agreement with the proposal to standardize risk ratings in the investment fund industry using a rolling 10-year standard deviation calculation with monthly returns based on market price, which generally exhibits a very tight relationship to the Net Asset Value of ETFs due to their creation/redemption mechanism[1].

However, we feel that the addition of the 6th risk category; Very High, seems unnecessary, in light of its extremely limited applicability. For example, of the 12 ETFs that have more than 10 years of history, there is only one that would go in the 'Very High' category, and of the ETFs that have less than 10 years of history, most of the 64 in Precious Metals, Natural Resources, and Passive Inverse/Leveraged categories would end up in the 'Very High' category but these, we believe would be appropriately recognized by being in the High category. Of the 2,453 mutual funds with 10 years of history, there are only 36 that would fall into the 'Very High' category

We believe High is a sufficiently meaningful risk recognition. Very High is not going to afford end users any additional protection especially if additional qualitative risks are defined as we request.

We appreciate the fact that the CSA has determined that a 10 year history should be used to avoid the pitfalls associated with selecting too short a timeline and to ensure that category changes are minimal to avoid investor confusion. However, there is a potentially meaningful disconnect between that approach and the fact that only 20% of mutual funds and 4% of ETFs have a ten year history and the average holding period for a mutual fund for an investor is approximately seven years and substantially less for an ETF.

There is also a concern that with a focus on such a "smoothed" risk profile investors may not gain a sufficient appreciation for the variability of returns that have historically occurred relative to the average return as expressed in the standard deviation calculation. We would therefore like some kind of formal recognition of short term volatility noted in addition to the ten year (long term) risk rating. This will ensure that investors understand that long term the product may be appropriate but in the short term there may be some additional volatility.

We believe there may be some concerns surrounding the practice of the fund companies selecting their own reference indexes however, we accept that each will be clearly explained in their prospectuses when the products are launched and we would have confidence in an industry committee established to provide on-going monitoring of the ratings. This could also be done by a third party in partnership with the industry.

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[1] In periods of heightened volatility, and/or in the event of any market dislocation, the tight relationship ensured by Designated Brokers may not hold as precisely as under more normal conditions. Additionally, looking at market price as opposed to NAV, could result in an overstatement of risk for ETFs whose “primary” liquidity does not afford them as a tight a bid/ask spread relationship as that of their more established peers.

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There is the need to draw investors' attention to the fact that while individual Fund/ETF risk qualifiers are important, they need to be incorporated into a risk assessment of an investor's entire portfolio.

The implementation of the new ratings is a concern to the investment fund industry as a whole. While the ETF industry has not used Risk Ratings in the past, with their implementation we do not know the impact on the brokerage community and their KYC/KYP information. If there is a variation from what they currently use – to what is being defined, we would like the regulators to allow for some phasing in period to ensure that clients do not have to sell a product unnecessarily. As all different types of investment funds are being included in investors' portfolios – we want to ensure that whatever methodology is decided upon that all products have the same implementation timelines so that investor confusion is minimized.

Finally, notwithstanding an understanding of the rationale for seeking to give a much greater emphasis to a quantitative approach, CETFA members support the inclusion of a qualitative element, which similar to asset class/fund categories, could be monitored by a third party, in conjunction with industry input and participation.

We thank you for allowing us the opportunity to comment on the Consultation Paper. Please feel free to contact the undersigned if you would like further elaboration of our comments.

Yours Truly,

Pat Dunwoody
Executive Director,
Canadian ETF Association