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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
Superintendent of Securities, Nunavut

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

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

Dear Sirs/Mesdames:

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

I write in regard to the above-referenced proposed mutual fund risk classification methodology (the "Proposed Methodology") on behalf of Dynamic Funds ("Dynamic," or "we").

**Introduction**

Dynamic is a division of 1832 Asset Management L.P., which offers a range of wealth management solutions – including mutual funds and managed asset programs – for private and institutional clients. 1832 Asset Management L.P. is a limited partnership, the general partner of which is wholly-owned by Scotiabank. It is a member of The Investment Funds Institute of Canada ("IFIC") and assisted with the preparation of IFIC's comment letter regarding the Proposed

Methodology. As such, and in addition to the comments below, we support the comments provided by IFIC on behalf of its members.

**Reliance on One Risk Measure has Limitations**

We believe that relying on standard deviation alone as a measure of risk is an inadequate and incomplete mutual fund risk rating methodology. Instead, a list of both quantitative and qualitative factors should be taken into consideration when assessing risk, including, among other things, a mutual fund's investment objectives, strategies and asset allocation, as well as sector and geographic diversification. In addition, consideration of the types of securities and financial instruments – fixed-income and/or equity securities and/or derivatives – used by a portfolio advisor in an investment strategy, and the weighting of such securities and financial instruments should be considered. In assessing the risk rating of a fund, a fund manager may also consider the risk ratings of other mutual funds they manage with similar investment mandates and strategies. In addition, a fund manager may also consider the risk ratings of other mutual funds managed by their peers that have similar investment mandates and strategies.

We believe that historical volatility as measured by the standard deviation of fund performance should also be *part* of a mutual fund risk methodology. We emphasize the word "part" because, as with historical performance not necessarily being indicative of future returns, so too a fund's historical volatility is not determinative of future volatility.

**Disruption and Confusion to Investors, Financial Advisors and Dealers**

Financial advisors recommend investments for their clients that are suitable and in accordance with each client's risk profile. When considering a mutual fund as a potential investment for a client, a financial advisor would consider, among other things, a fund's risk rating in order to recommend suitable investments that align with a client's investment risk profile. A change to the existing mutual fund risk rating may result in investors unnecessarily selling certain investments, rather than maintaining their set investment strategies.

The initial implementation of the Proposed Methodology would cause significant disruption and confusion to dealers and investors due to what will no doubt be a large number of funds shifting their respective risk categories. An IFIC survey indicates that all firms would be required to make an upward change (in terms of risk classification) for a large portion of their funds, some as high as 60% or more of their respective funds.

Currently, a mutual fund with a "medium" risk rating would be suitable for a client with a "medium" investment risk profile. Should the Proposed Methodology be implemented, that same mutual fund may have to shift its risk rating from "medium" to "medium-to-high," resulting in the same investment taking on a new risk profile but with no change to the underlying investments. As a result, a formerly suitable investment could, under the Proposed Methodology, become an unsuitable investment, and, as noted above, may encourage mutual fund customers to engage in unnecessary selling, and, in some cases, to prematurely incur capital gains or losses.

## Transition Period

If the Proposed Methodology becomes mandatory, we support IFIC's recommendation that there be two segmented transition periods for fund managers and dealers. Fund managers will need an appropriate and reasonable amount of time in which to generate new risk ratings based on adopting a new risk classification methodology firm wide. While dealers will need to address other consequential and significant challenges relating to suitability assessments such as dealer communications and operational challenges. IFIC estimates that fund managers will need a one to two-year transition period, and a transition period for dealers of up to three years.

## Level Playing Field

By virtue of focusing solely on mutual funds, the Proposed Methodology may have inadvertent consequences of communicating to investors the message that mutual funds are inherently riskier than other investment products. Investors have a broad range of investment products to choose from, including cash equivalents, equities, fixed income securities, ETFs, and a host of other options. We believe that it would be appropriate for the CSA to provide high-level principle-based direction, rather than limit the Proposed Methodology to mutual funds. This would result in a level playing field insofar as mutual funds and comparable products are concerned and may even prevent unintended market or product "dislocations."

## Fund Manager Discretion

We believe fund managers must have the discretion to classify their funds at either higher or lower levels of risk than as may be indicated by the respective volatility categories as long as such discretion is exercised in order to more accurately reflect the qualitative *and* quantitative factors relating to the mutual funds at issue.

## Six Category Scale and Risk Bands

As noted above, the risk bands contemplated in the Proposed Methodology could lead to a large number of funds being reclassified to a higher risk category absent a change in the fund's investment holdings. We are concerned that broad equity market funds currently rated as "medium" risk will become "medium-to-high" risk under the Proposed Methodology. For example, an equity fund that appropriately serves as a core investment for many investors could become, under the Proposed Methodology, an unsuitable investment due only to a shift in the risk rating categories. A sudden change in risk rating could undoubtedly result in significant disruption and confusion among all stakeholders, including investors, financial advisors and dealers.

## Use of a Referenced Index

We are unclear as to why the Proposed Methodology uses historical performance data as an appropriate reference index to determine the standard deviation and risk rating of a fund that does not have ten years of performance history. Very few mutual funds have ten-year performance records and, we are concerned that the use of "what if" calculations could mislead investors. Mutual funds that have only been in existence for two or three years may be significantly less or more volatile than selected referenced indexes.

The CSA may also wish to provide further guidance with respect to calculating the standard deviation for mutual funds whose investment objectives have changed or in cases where two or more funds have merged.

**Monitoring and Changing of Risk Categorizations**

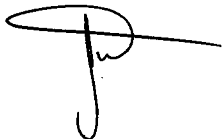
As indicated by IFIC, we also have concerns regarding the categorization of “borderline” funds, i.e. funds whose volatility level places them near the end of a range. Under the Proposed Methodology, these funds could easily swing between two risk categories from time to time, resulting in regular risk reclassifications, something that is arguably inconsistent with the CSA’s objective of stability in regards to risk categorization. In addition, the Proposed Methodology attempts to incorporate a mechanism with which to remedy such situations by examining a series of observations and averaging the results. We do not believe such a mechanism adequately addresses the concern as the average could also result in a “borderline” fund again requiring another risk reclassification. We would therefore recommend that fund managers be allowed to exercise discretion when classifying “borderline” funds to ensure some measure of stability in the risk classification process.

In addition, we believe that monitoring for changes more frequently than annually would not be required. As indicated above, changes in risk ratings result in significant disruption and confusion to all stakeholders, including investors, financial advisors and dealers.

* * *

I appreciate the opportunity to comment on the Proposed Methodology. Should you wish, I would be pleased to discuss this proposal further and answer any questions you may have.

Yours truly,



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