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March 12, 2014

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

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
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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 (the "Proposed Methodology")

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

Fidelity Investments Canada ULC ("**Fidelity**", "**we**", "**our**" or "**us**") is the 6th largest fund management company in Canada and part of the Fidelity Investments organization in Boston, one of the world's largest financial services providers. Fidelity manages over $88 billion in mutual funds and institutional assets and offers approximately 200 mutual funds and pooled funds to Canadian investors.

We have reviewed the comment letter submitted on behalf of the members of The Investment Funds Institute of Canada ("**IFIC**") and generally agree with their submissions.

Please find below our executive summary, general comments and specific responses to your questions on the Proposed Methodology.

EXECUTIVE SUMMARY

The CSA's development of a standardized risk classification methodology is laudable. We support principles-based regulation that leads to greater transparency, improved comparability and provides investors with more useful information to enable them to make better informed investment decisions. As such, Fidelity supports the CSA's proposal to mandate a standardized approach to providing investor suitability risk guidance in the fund facts document (the "**Fund Facts**"). Fidelity is equally supportive of the CSA's proposal to adopt a standardized approach to assessing risk guidance based on volatility risk, as measured by standard deviation ("**SD**").

However, we believe that there are some deficiencies in the Proposed Methodology that could lead to inappropriate risk guidance, inappropriate investment selection and potentially lower savings rates for investors, all of which is more particularly described below. We recommend that the CSA adopt IFIC's current risk classification methodology with a modification that would permit fund managers to exercise their discretion prudently to assign funds higher risk categories than their historical SD alone would indicate. This, we believe, would accomplish the CSA's stated objectives without the risk of jeopardizing investors' savings rates over the long-term by potentially causing investors to de-risk their portfolios unnecessarily.

GENERAL COMMENTS

Investor risk guidance and appropriate investment selection

The implementation of the Proposed Methodology could result in adverse consequences for investor suitability.

Fidelity's analysis indicates that the proposed SD bands and corresponding risk categories would result in Fidelity having to increase the risk rating for approximately 72% of our funds. This would include re-classifying all of our balanced funds (even those with relatively low equity exposures) from a "low-to-medium" to "medium" level of risk, without any associated change to how these funds are managed or their overall risk. Generally, the CSA's "low-to-medium" risk label would apply only to investment-grade bond funds.

Secondly, a potential consequence of the CSA's proposed labeling scheme would indicate to Canadian investors that those with a risk tolerance of "low-to-medium" or lower should have no exposure to equity securities in their portfolios. Fidelity has concerns that such guidance could lead to longer-term consequences for Canadian investors, specifically impacting the growth potential for retirement savings on a national level and the overall accumulation of retirement savings by investors.

A significant proportion of mutual fund dealers in Canada have based their investor suitability “KYC” assessments on the current IFIC risk categories and descriptors recommended in IFIC’s guidelines. As such, investors who report and have been assessed, for example, a “medium” risk tolerance, would be guided to invest in funds that are rated “medium” risk or lower. A consequence of the CSA’s proposed risk labeling would include dealers having to re-paper virtually all existing investor documents and potentially de-risk investors’ portfolios unnecessarily.

We believe that the CSA’s proposal to “re-label” the IFIC risk categories and “shift” the IFIC SD bands (for which no rationale has been provided by the CSA) would make funds more risky in description only. It also suggests to us that the CSA believes that a potentially large percentage of Canadian investors that have a nominal amount of exposure to equity investments through their mutual funds or other investments are making investments that are “too risky” for them. If the CSA proceeds with the Proposed Methodology, it could lead to a large percentage of Canadian investors re-allocating their investments needlessly, which in turn could result in unnecessary trading costs and adverse tax consequences.

<u>SD Bands</u>

Fidelity believes that mandating the current IFIC SD bands with the added modification that would permit fund managers to exercise their discretion prudently would accomplish all of the CSA’s objectives. However, we wonder how moving these bands would achieve the CSA’s goal of providing more useful information to investors.

During the second phase of the CSA’s Point of Sale initiative (“**POS2**”), the CSA made a number of changes to the presentation of risk in the Fund Facts that took effect on January 13, 2014. The new disclosure explains that the risk scale is meant to measure volatility in an easily understood manner and more clearly articulates volatility risk and the risk-return linkage. We agree that the risk changes made during POS2 will benefit investors. However, we believe the creation of break points that differ from IFIC’s is of little benefit to investors. Rather, during implementation and in the future, the new risk bands are likely to lead to confusion and unintended consequences for investors as they would be required to invest in more conservatively labelled funds.

We note that the majority of Canadian mutual fund managers currently use the approach recommended by IFIC to determine the overall risk level of a fund. The adoption of this approach has become ever more widespread in recent years, particularly since the recent clarification of the Fund Facts requirements directing fund managers to disclose investor suitability risk in terms of volatility risk. Also, we believe that the current IFIC risk classification methodology would lead to better risk estimates for a fund's potential volatility risk over time.

From our perspective, mutual funds, including balanced and well diversified equity funds are great investments for retail investors saving for retirement. The creation of new break points that differ from IFIC's would do nothing more than limit an investor's access to equity exposure, which we believe would ultimately frustrate the CSA's overarching goal of investor protection.

Discretion to be more Conservative

The Proposed Methodology is anchored in a quantitative process. We endorse an objective and transparent quantitative foundation to any risk assessment methodology. However, we believe that compelling fund managers to derive risk guidance solely from historical SD is problematic.

The Proposed Methodology cannot capture historically unobserved risks such as those associated with portfolio manager changes, investment strategy changes and the potential impact of the liquidity of certain securities in times of financial market stresses. We believe that fund managers should be encouraged to apply discretion prudently in situations where a higher risk classification is warranted.

SPECIFIC COMMENTS

The Proposed Methodology poses a number of questions for consideration (as specified in Annex B of the Proposed Methodology). In this section we respond to each of those questions.

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.**

As stated in our general comments, Fidelity supports mandating SD as foundation and basis for measuring volatility risk over time. This would help achieve the CSA's goal of providing investors with more comprehensive, consistent and comparable information on how a fund's risk level is determined. However, we believe that there are deficiencies that the CSA should address prior to adopting the Proposed Methodology either as a rule or as guidance. These deficiencies are discussed in further detail below.

We believe that the adoption of the IFIC risk classification methodology would not compromise the CSA's goal of enhancing transparency and improving comparability of risk disclosure among funds in Canada. Many fund managers, including Fidelity, adhere to IFIC's methodology. This is the standard industry practice in Canada. If the CSA adopts IFIC's methodology with the modifications we recommend above, we believe that the CSA's stated objectives of achieving consistency and stability over time would be accomplished.

In the event the CSA proceeds with mandating the Proposed Methodology, a one-year transition period for fund managers would be appropriate. This would allow for systems enhancements, proper testing and risk disclosure changes to be made between Fund Facts and prospectus renewal dates. We also remind the CSA that implementing the Proposed Methodology at the same time that it implements some of the fee disclosure rules as mandated under NI 31-103 may create confusion for both investors and advisors.

However, we believe the transition period should be longer for dealers to implement. At a minimum, we believe that two years would be appropriate. The impact of the Proposed Methodology to advisors and dealers would be much greater than it is to fund managers. The added transition period should give advisors and dealers enough time to re-assess investor suitability, explain any changes to investors and re-adjust their portfolios as necessary.

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 the Proposed Methodology should apply to similar investment products, such as ETFs.

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.**

From a fund manager's perspective, we generally agree with the CSA's perspective on these items. With respect to the cost of implementing the Proposed Methodology, we believe that the CSA should, at a minimum, align the transition period with a fund's annual prospectus renewal. We believe this would avoid unnecessary costs associated with issuing press releases, prospectus and Fund Facts amendments during a fund's off-cycle period.

We note that the costs and/or operational concerns of implementing the Proposed Methodology are expected to be more significant for dealers and advisors than for fund managers.

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?**

Fidelity does not agree with the CSA's removal of a fund manager's discretion, especially as applied to balanced, narrowly defined or niche funds.

A purely quantitative calculation for risk classification would not capture historically unobserved potential risks and would need to be supplemented by qualitative criteria to ensure full, true and plain disclosure of material facts impacting the overall risk level of funds. Fidelity believes that fund managers are generally in the best position to assess potential risks and how they apply to a fund. Therefore, we urge the CSA to allow fund managers to use their discretion only when increasing a fund's risk classification.

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.**

No, we would not. We believe SD is appropriate.

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.**

No, we would not recommend a different volatility risk measure for any specific fund products.

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.**

No, we would not suggest that an alternative frequency be used.

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.**

The proposed 10-year period is reasonable, but we believe that the IFIC guidance based on the average rolling 5-year volatility is preferable.

9. Keeping the criteria outlined in the introduction above in mind, should we consider an alternative approach to calculation by series/class? Please supplement your recommendations with data/analysis wherever possible.

No, an alternative approach to calculation by series/class should not be considered.

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 have indicated (above and below) our concerns about the proposed SD bands and their corresponding risk categories. While we do not have material objections to the proposed calculation methodology for SD (except to reiterate that we believe that the current IFIC risk guidelines would lead to better risk estimates for a fund's potential volatility risk over time), we do have some concerns about the proposed guidance for the use of proxies or reference indices for estimating the potential risk of new or young funds. We ask that the CSA clarify our concerns below.

We note that the CSA's criteria for "acceptable" reference indices appear to be in conflict with, or at a minimum have the potential to undermine, the objective of identifying indices that would represent the most appropriate or "ideal" proxy for calculating volatility risk estimates. Among the acceptable reference index conditions, we request clarification on the conditions that the indices be "widely recognized" and "publicly available". On the criterion of "publicly available", we note that very few index publishers issue monthly data or make the SD of index returns available to the public free of charge.

We also note 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. Many asset classes and specific industry indices tend to be available by subscription through data providers and publishers, thus they cannot be considered to be available "publicly". Below we list four examples of narrow asset classes and industry specific fund types and the corresponding indices that we would identify as the best proxy for volatility risk estimates.

Fund or investment strategy	Index most likely to comply with CSA's "acceptable" reference index criteria		Index most likely to comply with CSA's "ideal" reference index criteria	
	Index name	Correlation of returns to fund/ investment strategy	Index name	Correlation of returns to fund/ investment strategy
U.S. High Yield Bond Fund	Barclays U.S. Aggregate Bond Index	0.55	Bank of America U.S. High Yield Master II Index	0.94
U.S. Floating Rate Bond Fund	Barclays U.S. Aggregate Bond Index	0.46	S&P/LSTA Leveraged Loan Index	0.98
Global Technology Sector Fund	MSCI World Index	0.81	MSCI Global Technology Index	0.96
Global Real Estate Sector Fund	MSCI World Index	0.83	EPRA / NAREIT Developed Market Index	0.99

In the absence of clarification, we recommend that fund managers use indices that fulfill the other conditions indicated, the most germane of which being having returns highly correlated to the expected returns of the fund and be administrated by an organization that is not affiliated with the fund or the fund manager.

11. Keeping the criteria outlined in the introduction above in mind,

i. Do you agree with the proposed number of risk bands, the 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.

We do not agree with the proposed six point risk band scale and breakpoints for the reasons stated in this letter.

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.

In terms of frequency of monitoring, we do not agree with the CSA's monthly monitoring proposal. We believe that monthly monitoring is onerous and would frustrate the CSA's objective of seeking consistency and stability of risk ratings over time. We recommend that the CSA adopt an annual monitoring process that is tied to a fund's annual renewal.

We are concerned with how the proposed monthly monitoring process would apply to "borderline" funds that sit on the higher end of a risk band range. These funds would typically fluctuate between two risk bands from month to month, which, under the Proposed Methodology, would require more frequent re-classification. Also, where such circumstances warrant the need to calculate the 12-month average risk classification from the current and preceding 11 monthly risk classifications, the average result would not necessarily resolve this issue. In our view, should such circumstances arise, this would be another situation that warrants a fund manager's prudent exercise of discretion.

Finally, where a fund manager is required to re-classify a borderline fund more frequently than necessary, an amended Fund Facts and press release must be filed within ten days of the last monthly calculation of the fund's SD. This, we believe, is costly, burdensome and would likely lead to investor confusion.

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

No, we believe a 10-year retention period is appropriate as this would align with the proposed 10-year SD calculation.

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.

In our view, should the CSA proceed with the Proposed Methodology, we expect there to be significant transition issues that might arise.

From a fund manager's perspective, the impact of this move would result in increased costs associated with, among other things, prospectus and Fund Facts amendments during off-cycle periods, issuing press releases, communicating changes to dealers and advisors, system enhancements and resources as well as changes to marketing material. However, we expect that upon implementation there is likely to be greater transition issues for dealers and advisors because of the potential impact to investors and suitability requirements. For example, as a result of risk re-classifications, advisors would need to re-assess investors' risk profiles to determine suitability with respect to affected funds. They would need to explain any changes and suggest alternative solutions to meet their clients' needs. We note that the majority of Fidelity's funds would be required to move risk categories. As a result, advisors with clients that hold Fidelity funds would have to re-visit their clients' KYC documents and adjust their investments as necessary.

We urge the CSA to work with IIROC and the MFDA in an effort to minimize the impact on investors as well as the costs and additional resources associated with the initial and future application of the Proposed Methodology.

CONCLUSION

In conclusion, Fidelity supports the CSA's proposal to mandate SD as the standardized approach to assessing risk guidance based on volatility risk, and we support the standardized approach to providing investor suitability risk guidance in the Fund Facts. However, we recommend that the CSA further review and consider investor consultation and research on the potential impact to Canadian investors' savings rates and investor suitability.

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

Yours truly,

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