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Delivered By Email: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

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

Attention:

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

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

Dear Sirs and Mesdames:

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

Introduction

We are writing to provide you with comments on behalf of Scotia Securities Inc. ("SSI") with respect to the Canadian Securities Administrators' ("CSA") *Notice 81-324 and Request for Comment – Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* published on December 12, 2013 (the "Proposals"). We appreciate the opportunity to participate in this discussion.

SSI is a mutual fund dealer that distributes mutual funds through over 1000 Scotiabank branches in Canada. We administer over \$30 billion in proprietary and third party mutual funds held in approximately 1.2 million investment accounts.

We are members of the Investment Funds Institute of Canada ("IFIC") and have participated in the deliberations of IFIC on this issue and fully support the positions taken by IFIC in response to the Proposals.

We support the objective of establishing a uniform principle based methodology for determining mutual fund risk rating. We believe that risk categories based on the measurement of standard deviation over time are an appropriate and practical means for determining mutual fund risk rating.

The Proposals present significant challenges for mutual fund dealers. In particular, the prospect of many mutual funds shifting risk category as a result of the new methodology outlined in the Proposals presents a serious concern for investors, advisors and dealers. We do not believe the standard deviation bands included in the Proposals are appropriate, and, for reasons described below, if they are adopted the result will be investor confusion and significant industry disruption. We believe the CSA's objective can be realized without causing confusion and disruption, if the standard deviation bands used in the IFIC Methodology, as described below, are adopted as part of the Proposals.

Challenges for Mutual Fund Dealers

IFIC has established Voluntary Guidelines for Fund Managers Regarding Fund Volatility Risk Classification (the "IFIC Methodology"). The IFIC Methodology is used by the vast majority of fund managers in Canada as the basis for mutual fund risk rating. The IFIC Methodology utilizes five standard deviation bands. The Proposals recommend a change to six standard deviation bands, as illustrated in the table below.

Risk category	CSA – SD Bands	IFIC – SD Bands
Low	0 – 2.0	0 – 6.0
Low to Medium	2.0 – 6.0	6.0 – 11.0
Medium	6.0 – 12.0	11.0 – 16.0
Medium to High	12.0 – 18.0	16.0 – 20.0
High	18.0 – 28.0	> 20.0
Very High	> 28.0	

Source - IFIC Presentation "CSA Fund Risk Methodology Consultation Breakfast Briefing"

From a review of the above table it is evident that the proposed risk categories, if adopted, will result in significant numbers of mutual funds shifting to a higher risk rating. An IFIC survey shows that many firms will have over 60% of their funds shifting to a higher risk category.

This change in risk rating will occur in spite of there being no material change to the mutual fund and its investment holdings.

If the proposed standard deviation bands are implemented, the immediate result will be investor confusion. It will be difficult to understand or explain to investors why a mutual fund investment would have increased risk when there has been no change to the mutual fund and its investment holdings.

The prospect of a major shift in mutual fund risk ratings is of great concern to SSI. Mutual fund dealers use mutual fund risk rating as the basis for assessing the suitability of investments (see MFDA MSN-0069). Currently, a mutual fund with a medium risk rating would be suitable for an investor with a medium risk tolerance. If the same fund shifts its rating to medium/high, it would become unsuitable for the same investor.

If the Proposals are implemented, the result will be a major disruption to investors and dealers. Dealers and their advisors will have to manage new concerns regarding investment suitability. Advisors will have to engage with investors and explain to them that their investments, while not changing in any material way, are suddenly unsuitable. To ensure that investment holdings in mutual funds continue to remain suitable, many investors will have to choose to either switch to a more conservative mutual fund or adopt a more aggressive risk tolerance. The effort to manage this issue with investors will require significant resources and capacity.

We also note that there is no evidence to show that investor interests or protection will be enhanced by using proposed standard deviation bands instead of the IFIC Methodology.

Transition

Transition will occur in two phases and raise significant issues. The first phase will involve fund managers implementing the new risk classification methodology. The second phase will involve dealers managing the impact of changes in fund risk rating on the suitability of investments in customer accounts. Should the proposed methodology proceed, dealers will require significant transition time in order to resolve suitability challenges with investor accounts.

Conclusion

The objective of establishing a uniform principle based methodology for determining mutual fund risk classification can be realized without causing investor confusion and industry disruption if the standard deviation bands used in the IFIC Methodology are adopted as part of the Proposals. We therefore urge the CSA to adopt the IFIC standard deviation risk bands.

We appreciate the opportunity to comment on these important proposals.

Yours very truly, Scotia Securities Inc.

By: 
Neil Macdonald,
Managing Director,
Scotia Asset Management