

March 18, 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

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Dear Sirs/Mesdames:

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

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We are writing to provide our comments on *Notice 81-324 and Request for Comment – Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts* (the “**CSA Proposal**”) published by the Canadian Securities Administrators (the “**CSA**”) on December 12, 2013.

Mackenzie Financial Corporation (“**Mackenzie Investments**”) is a portfolio adviser and investment fund manager registered under *National Instrument 31-103* with total assets under management of over \$67 billion – including mutual fund assets under management of approximately \$47 billion – as of February 28, 2013. Mackenzie Investments is a wholly-owned subsidiary of IGM Financial Inc., which is a member of the Power Financial Corporation group of companies. Mackenzie Investments distributes its products through more than 250 dealers representing approximately 41,000 financial advisers.

At Mackenzie, we are committed to the financial success of investors, through their eyes. That is our overarching vision and it is through that lens that we provide these comments. We agree with the statement in the Introduction to the CSA Proposal that a standardized risk classification methodology would serve investors best, as it would provide a consistent and comparable basis for measuring the risk of different mutual funds. We also agree with the seven principles set out in the Introduction to Annex A of the CSA Proposal. However, we do not believe that the Proposed Methodology is the best way of fulfilling these seven principles. We believe that the IFIC Methodology offers a better foundation for a standardized risk classification system.

Our reasons for these views are provided in our responses to the questions in Annex B of the CSA Proposal, which follow.

- 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.*

We believe that the CSA should mandate a risk classification methodology. However, we also believe that the IFIC Methodology, not the Proposed Methodology, is the methodology that should be mandated.

As the Investment Funds Institute of Canada (“**IFIC**”) observed in its comment letter dated March 12, 2014, the IFIC Methodology “is already in place and currently used by the vast majority of the industry”. Thus, an ancillary benefit associated with mandating the IFIC Methodology instead of the Proposed Methodology is a relatively shorter transition period. In this case, we would recommend a transition period of one year. For the reasons discussed in this letter, if the Proposed Methodology were to be adopted a considerably longer transition period would be required.

- 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?*

Canadian investors have access to a broad range of investment funds, including mutual funds, exchange-traded funds and closed-end funds. In keeping with the first and third principles set out in the Introduction to Annex A of the CSA Proposal, we agree that the selected risk classification methodology should be applicable to all investment funds.

With respect to ETFs, it is the market price, not the net asset value per unit, that determines the investor's experience of return and risk. That said, we recommend further study of this question, and we urge the CSA to seek the views of ETF managers on this question.

We also note that the investment choices available to Canadian investors are not limited to investment funds, but include stocks, bonds, structured notes, and so on. Returning to the statement in the Introduction to the CSA Proposal, one might argue that the risk classification methodology that serves investors best is the one that provides a consistent and comparable basis for measuring the risk of the broadest array of investments available to Canadian investors, including but not limited to investment funds. While we acknowledge that this is outside the scope of the CSA Proposal, we submit that any risk classification methodology applied to investment funds should not be so inconsistent with how investors perceive the risks of other investments as to frustrate comparisons between investment funds and other investments.

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 support the use of a standardized risk classification methodology. However, we also believe that the IFIC Methodology, not the Proposed Methodology, should be employed as this standard.

As we have noted, the IFIC Methodology is currently used by the vast majority of mutual fund managers. Thus, just as use of the IFIC Methodology will permit a relatively shorter transition period, so too will be relatively less costly for investment fund managers and dealers to implement.

If the Proposed Methodology is implemented, we will have to revise approximately 2,000 unique Fund Facts documents to reflect the new six risk categories. Furthermore, we estimate that two thirds of our mutual funds will need to be reclassified, even though nothing about their operations, management or investments will have changed. As discussed under question 11, this will sow confusion among investors as advisors will be forced to explain to them why their portfolio may no longer be suitable under their current risk profile even though there have been no changes to their investments, the markets, or their overall personal circumstances.

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 do not agree with this approach, which we regard as unduly restrictive. We believe that an investment fund manager should have the discretion to adjust the classification of an investment fund, either higher or lower than what is prescribed by the basic methodology, where the prescribed classification does not accurately represent the risk of the investment fund. Under the Proposed Methodology, this might be appropriate in the case of (i) an investment fund whose investment objectives, strategies and/or portfolio management have experienced a material change within the past ten years, or (ii) a new investment fund whose performance may be expected to differ significantly from the performance of its reference index.

The CSA might reasonably require of investment fund managers who exercise discretion to adjust the risk classification of an investment fund, to do so on a reasoned, consistent basis under a written policy of the manager, and that all decisions are properly documented.

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.***

We support the use of historical standard deviation – either of the investment fund, or of its reference index, as applicable – as the primary basis for any risk classification methodology. However, as we stated in our answer to question 4, we do not believe that historical standard deviation will provide investors with the best indication of risk in all circumstances, and for this reason, we believe that investment fund managers should have the discretion to adjust the classification of an investment fund, either higher or lower than what is indicated by historical standard deviation, where 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.***

We agree that historical standard deviation is an appropriate basis for a risk classification methodology. However, as we stated in our answer to question 4, we do not believe that historical standard deviation will provide investors with the best indication of risk in all circumstances, and for this reason, we believe that investment fund managers should have the discretion to adjust the classification of an investment fund, either higher or lower than what is indicated by historical standard deviation, where appropriate.

We note that the Fund Facts document already requires the disclosure of another risk measure – three-month drawdown – in the section “Best and worst 3-month returns”.

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 practice of using monthly returns to calculate standard deviation.

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.***

As we have stated, we agree with the seven principles set out in the Introduction to Annex A of the CSA Proposal, including the principle that any risk classification methodology should fairly reflect market cycles and broad market fluctuations. However, this principle may conflict with the principle that the methodology should be “meaningful”, particularly in the case of an investment fund whose

investment objectives, strategies and/or portfolio management have experienced a material change within the time period used to classify the investment fund. This is why, as we stated in our answer to question 4, we believe that an investment fund manager should have the discretion to adjust the classification of an investment fund.

We believe that the tension between these two principles is mitigated in the IFIC Methodology, which uses a variety of time periods. The IFIC Methodology incorporates average annual standard deviations calculated over time periods from one to ten years, as well as a comparison of rolling three- and five-year standard deviations compared to a defined category benchmark. This is one of the reasons why we recommend that the IFIC Methodology, not the Proposed Methodology, be used as the foundation of the standardized risk classification system the CSA seek to establish.

**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 believe that the risk classification applied to a particular investment fund should apply in respect of all series and/or classes of that investment fund.

**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.***

The CSA identify five requirements for an index to be acceptable as a reference index, and we agree with these. However, the CSA go on to articulate seven principles for the selection of a reference index, and we believe that some of all of the first four principles will be impossible to uphold in all circumstances.

Mackenzie Cundill Emerging Markets Class is an example of a fund for which the selection of a reference index is problematic. This fund, which only has a seven-year history, is a concentrated fund that invests in smaller-cap emerging market stocks and in frontier markets. Its presumed reference index would be the MSCI Emerging Market Index, yet the fund differs materially from this index: of the top 20 holdings in the fund, only one is an index constituent.

We offer this example as a clear illustration of the challenges of reference index selection. We could offer others. Mackenzie's funds are designed to be actively managed and frequently do not resemble any index. Investors are paying us for active management and we believe that, among other things, this requires our funds to look and behave differently from indices.

We note that, relative to the Proposed Methodology, the IFIC Methodology is less reliant on the use of reference indices, since it requires only three years of historical performance data.

No matter which methodology is employed – the Proposed Methodology, the IFIC Methodology, or some other – there may be circumstances in which its application does not provide investors with the best indication of risk. For this reason, as we stated in our answer to question 4, we believe that investment fund managers should have the discretion to adjust the classification of an investment fund, either higher or lower than what is indicated by historical standard deviation, where appropriate.

***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.***

As we have stated above, we believe that the IFIC Methodology is preferable to the Proposed Methodology as the foundation of the standardized risk classification system the CSA seek to establish.

We do not have a developed view on the ideal number of risk bands. We do note that the larger the number of risk bands, the greater the frequency with which risk classifications will change, and the greater the potential for confusion among investors.

We believe that any banded approach should enable investors to distinguish money-market and similar funds from other types of low-risk investment funds. We note that this was possible under the IFIC Methodology that most mutual fund managers used prior to the introduction of Fund Facts, because that version of the IFIC Methodology employed six risk bands, including both “very low” and “low” risk bands. These two bands were consolidated into a single “low” risk band by the CSA upon the introduction of Fund Facts, which require mutual funds to be classified according to five risk bands. In our view, the CSA’s rationale for now moving back to six risk bands is not well explained as no reasons are offered as to why the six band risk scale is more meaningful or effective than the current five band risk scale.

Most concerning to us is that under the Proposed Methodology, many investment funds will need to be reclassified – and nearly all of these to higher-risk classifications – even though nothing about their operations, management or investments will have changed. As IFIC stated in its comment letter dated March 12, 2014, a survey of nineteen IFIC members revealed that all but one of the respondents expects 50% or more of its investment funds to be reclassified. Four of those respondents also indicated the direction of the expected reclassifications. Among these four managers the percentage of reclassified funds expected to see an increased risk rating are 89%, 95%, 95% and 98%. Such a wholesale change would increase confusion among dealers and advisors, and may actually prevent investors from achieving their financial objectives.

Advisors would have to review a slew of revised classifications against the know-your-client (“KYC”) information maintained for each investor they serve. Where the revised classifications are inconsistent with the KYC information, advisors will have to consult with investors and either revise their KYC information to conform to their current investments, or rebalance their investments to conform to their KYC. Where the latter occurs, an investor may move from equity funds to fixed-income funds, thereby increasing their interest-rate risk and decreasing their expected long-term returns. In an environment where investors are living longer, it is hard to see how such rebalancing serves their interests. For example, an investor who reduced risk in March 2009 by selling the average Canadian equity mutual fund and buying the average Canadian fixed income mutual fund would have earned 28% in the fixed-income fund over the next five years – but would have foregone the 112% gain that the equity fund provided over the same period.

All of this disruption might be justifiable if the Proposed Methodology produced demonstrably better risk classifications than the IFIC Methodology. However, we believe that the opposite is more likely to be true. As we stated in our answer to question 2, any risk classification methodology applied to investment funds should not be so inconsistent with how investors perceive the risks of other investments as to frustrate comparisons between investment funds and other investments. In the case of a large-capitalization stock that is a constituent of the S&P/TSX Composite Index, we know that most IIROC dealerships would generally rate it as a “medium” risk investment for suitability assessment purposes. That assessment is rarely, if ever, disputed by clients or IIROC. Therefore, it is not logical that the S&P/TSX Composite Index itself – being a broadly diversified index of such stocks – should be classified as “medium to high” risk for the purposes of classifying investment funds.

Accordingly, we recommend that the IFIC Methodology be used as the foundation of the standardized risk classification system the CSA seek to establish. Because this methodology is already in wide use, this will be less disruptive to investors, advisors, dealers and fund managers. More importantly, insofar as it provides a more consistent and comparable basis for comparing the risks of investment funds, not only against other investment funds but also against other investments, it better serves the interests of Canadian investors.

***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 not agree with the proposed process for monitoring risk ratings. We do not believe that it would achieve an adequate degree of stability in the risk classification process with respect to normal trends and fluctuations of markets. We question the overall usefulness of a risk indicator that could theoretically shift on such a frequent basis. We believe the process would be onerous for investment fund managers, disruptive for advisors, and – most importantly – disruptive and possibly even alarming for investors. Much evidence points to the benefits that investors derive from remaining invested for the long-term rather than moving in and out of the markets based on short-term factors. Confidence in their investments helps investors stay invested over the long term, and our concern is that the Proposed Methodology and the potential for monthly risk changes may actually harm investors by reducing their confidence in their funds and fund manager.

As we noted in our answer to question 3, we maintain approximately 2,000 unique Fund Facts documents. In the case of a material change to the risk classification of an investment fund, the Proposed Methodology requires us to file an amended Fund Facts for each series of that investment fund within ten days of calculation that triggered the material change. The CSA state that “we expect these types of changes to occur infrequently”, but it is not clear to us what “infrequently” means, nor whether our experience will be typical of what the CSA expects will be the industry experience. Finally, it is not clear to us whether the requirement to amend Fund Facts due to a change in risk classification triggers a requirement to update other contents of this document, such as the management and trading expense ratios, the details of the fund’s investments, and its historical performance.

Advisors will face parallel challenges if they are confronted with investment funds whose risk classifications change frequently. They must reconcile these dynamic risk classifications with the more static requirements of their 'know-your-client' forms. Any divergences will be burdensome for advisors and may be unduly alarming for investors.

As an alternative, we propose an approach wherein, if the risk classification of an investment fund changes, this change is reflected when Fund Facts are next renewed. This implies a lag of one year at most. This disclosure would be supplemented by monthly updating of the standard deviation data, both on the manager's web site and on third party sites. This approach is much less onerous for investment fund managers and much less disruptive for dealers and investors, while still ensuring the availability of timely data for investors. We note that this proposed approach is consistent with the way that other performance data, *i.e.*, returns, are treated today.

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

We believe the proposed ten-year period is unnecessarily long. We believe that a seven-year retention period is appropriate, and we note that this is consistent with other record retention requirements applicable to investment fund managers.

**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?**

We have argued for a standardized risk classification system founded on the IFIC Methodology, rather than the Proposed Methodology, and updated according to the procedure we propose in our answer to question 12. Among the benefits of these choices are a shorter transition period, as we stated in our answer to question 1, and far less disruption for investors and the firms that serve them, as we stated in our answer to question 11.

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Thank you for the opportunity to provide comments on the Staff Notice. Please feel free to contact the undersigned or Brad Gerster ([brad.gerster@mackenzieinvestments.com](mailto:brad.gerster@mackenzieinvestments.com)) or Nick Westlind ([nick.westlind@mackenzieinvestments.com](mailto:nick.westlind@mackenzieinvestments.com)) if you wish to discuss this further or if you require additional information.

Yours truly,

**MACKENZIE FINANCIAL CORPORATION**



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