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Mr. Viraf Nania
Mr. Dennis Yanchus
Mr. Abid Zaman
Ontario Securities Commission
20 Queen Street West, 20th Floor
Toronto, Ontario M5H 3S8

Dear Sirs:

RE: Canadian Securities Administrators ("CSA") Notice 81-324 ("Notice") - CSA Proposed Mutual Fund Risk Classification Methodology ("Proposed Methodology")

This letter provides comments with respect to the Proposed Methodology on behalf of the IPC group of companies ("IPC"). IPC includes Counsel Portfolio Services ("Counsel"), an Investment Fund Manager ("IFM") registered with the Ontario Securities Commission, IPC Investment Corporation ("IPCIC") registered with the Mutual Fund Dealers Association of Canada ("MFDA") and IPC Securities Corporation ("IPCSC") registered with the Investment Industry Regulatory Organization of Canada ("IIROC").

The CSA has requested feedback on the Proposed Methodology in the Fund Facts and, in particular, whether the CSA should (i) mandate the Proposed Methodology or (ii) adopt it only as guidance for investment fund managers.

The CSA has also requested feedback on whether the Proposed Methodology could be used in similar documents to Fund Facts for other types of publicly-offered investment funds such as ETF's.

Finally, the CSA has requested feedback to questions posed in Annexes A and B of the Notice as well as on other aspects of the Proposed Methodology.

Executive Summary

IPC agrees that an industry standardized risk classification methodology would be useful to investors but would favour improvements made to the long standing *Investment Funds Institute of Canada ("IFIC') Voluntary Guidelines for Fund Managers Regarding Fund Volatility Risk Classification* ("IFIC Risk Methodology") instead of introducing a new and dramatically different methodology.

The introduction of the Proposed Methodology will have significant negative impacts on industry participants as well as on their respective clients. These impacts will include client confusion and an overall erosion of the trust clients have in their advisory relationship and in the investment industry absent any changes in the mutual fund investments they hold.

The research and background for the Proposed Methodology's new risk bands has not been adequately detailed within the CSA's Notice and would introduce unnecessary and disruptive changes to mutual fund risk ratings.

The CSA has underestimated the costs of implementation of the Proposed Methodology.

General Comments

We commend the CSA's efforts to help improve the quality, standardization and clarity of the information made available to investment advisors and prospective investors about mutual funds offered for sale in Canada so that investors are in the best position possible to make informed investment decisions. However, while the Proposed Methodology has a number of positive elements, there are certain aspects of it that IPC is convinced will be disruptive to the industry (both manufacturers and dealers) and lead to erosion of the trust relationship that exists between investment advisors and their clients.

Currently the instructions sections of in National Instrument 81-101 F1 (Contents of Simplified Prospectus) and F3 (Contents of Fund Facts Document) provide sufficient instruction on both the form of risk disclosures required in each document as well as the methodology with which a manager should determine those risks.

For ten years, the IFIC Risk Methodology has assisted fund managers regarding the classification and comparisons of the volatility risk associated with different types of mutual fund categories. The IFIC Risk Methodology and guidelines are designed to assist with standardizing terminology, categories, and volatility risk descriptions of funds. We support and encourage these standard approaches. It is noteworthy, that according to IFIC, the majority of IFMs have adopted the IFIC Risk Methodology in order to risk rate their mutual funds. Therefore, without mandatory prescription, the industry has come together to provide the quality, standardization and clarity to investors that the CSA is striving for with their Proposed Methodology. As such, we urge the CSA to reconsider its approach on this matter in favour of working with IFIC to blend the best features of the Proposed Methodology into the current IFIC Risk Methodology.

Please note that our direct response to a specific question posed by the CSA in Annex B should not, in and of itself, be interpreted as support for the Proposed Methodology.

Annex B CSA Questions (and IPC Comments):

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?

    Comments

    As noted above, we urge the CSA to reconsider its approach on this matter in favour of working with IFIC to blend the best features of its Proposed Methodology into the current IFIC Risk Methodology. However, to answer the threshold question directly, IPC would prefer to see the CSA adopting the Proposed Methodology only as guidance subject to a number of recommended changes to the Proposed Methodology outlined herein.

Are there other means of achieving the same objective than by mandating the Proposed Methodology, or by adopting it only as guidance?

> **Comments**
>
> We don't believe there is a need to depart dramatically from the approach being considered. Rather, we believe the ideal solution favoured by all stakeholders will be a blending of best features of the existing IFIC Risk Methodology and the CSA's Proposed Methodology.

We request feedback from investment fund managers and dealers on what a reasonable transition period would be for this.

Comments

Please refer to question 14 for comments regarding transition periods.

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?

Comments

Indeed, in order to create a level playing field within the industry, the CSA should consider collaborating with IFIC and other industry associations such the Investment Industry Association of Canada ("IIAC") to design a risk rating methodology solution that applies to all issuers (governments, corporations or investment trusts) across the spectrum of investments including common and preferred stocks, bonds, notes, debentures, derivatives, mutual funds and ETFs. The current Proposed Methodology, if mandated, would unfairly prescribe a risk rating methodology to one class of issuer (IFMs) while allowing the remaining products in industry to be risk rated arbitrarily by the investment dealers in the case of stocks or by an independent credit rating agency in the case of corporate or government debt obligations. These approaches are disjointed.

For instance should standard deviation be calculated with returns based on market price or net asset value per unit?

Comments

One might conclude that the difference between the mathematical outcomes might be negligible thus resulting in the same determination about risk rating. However, that conclusion cannot be drawn without a detailed study of the differences between the data computed using market vs. NAV per unit returns. We would urge the CSA to include ETF issuers in the study before publishing any proposals.

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.

Comments

We agree that standardization, in general, will benefit both investors and the capital markets by providing consistency and transparency of disclosure and improved comparability of investment fund products. However, we believe that this standardization has already been achieved by the fact that the majority of IFM's have adopted the IFIC Risk Methodology. Currently, without mandatory prescription, the industry has come together to provide the quality, standardization and clarity to investors that the CSA are striving for with the Proposed Methodology. As such, we urge the CSA to reconsider its approach on this matter in favour of working with IFIC to blend the best features of its Proposed Methodology into the current IFIC Risk Methodology.

We respectfully disagree with the CSA's perspective regarding the cost of implementation. When we consider costs, we consider not only the cost of additional resources to calculate the risk ratings but also the downstream impacts on processes, advisors and clients. Through a recent IFIC survey, we've learned that the large majority of IFMs in industry will see at least half their mutual funds moved up by one risk category when, in fact, nothing has changed in the underlying funds' investment objectives, strategies or fundamental risks. There will be significant impacts and costs in terms of the time, effort and resources spent dealing with the effect of such changes.

Based on the information shared with us by IFIC, in our estimation;

- virtually every IPC advisor will be required to deal with the impacts of these changes with their clients;

- over 80% of our Counsel and IPC unitholders will be impacted by these changes.

This will require dealers, IFMs, advisors and their clients to sacrifice time spent on other, more worthwhile endeavours to deal with changes in risk ratings when nothing fundamental has changed with respect to the mutual funds' investment objectives, strategies or the risks identified in Part B of the funds' simplified prospectus.

This will lead to other indirect costs such as the erosion of the trust relationship between the advisor and his/her client due to the inability of the advisor to rationalize these changes on behalf of the CSA. The Proposed Methodology may lead to confusion, an increase in complaints, potential litigation and an overall erosion of trust and loss of confidence in our industry. All of this will be quite costly.

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?

Comments

Notwithstanding the other feedback we've provided in this letter, we believe IFMs should have the discretion to classify a fund either higher or lower than the quantitative volatility category indicated by the statistical testing performed. IFMs should be required to maintain good corporate governance evidence documenting the reasons for deviating from the methodology when they do so. We suggest that such matters be brought to the IFM's Independent Review Committee ("IRC") for approval. This would allow IFM's to use additional quantitative and qualitative measures to draw the most appropriate conclusion about a fund's risk while having to support their conclusions to the IRC to ensure risk conclusions are in the best interests of unitholders guided by the requirements of National Instrument 81-107.

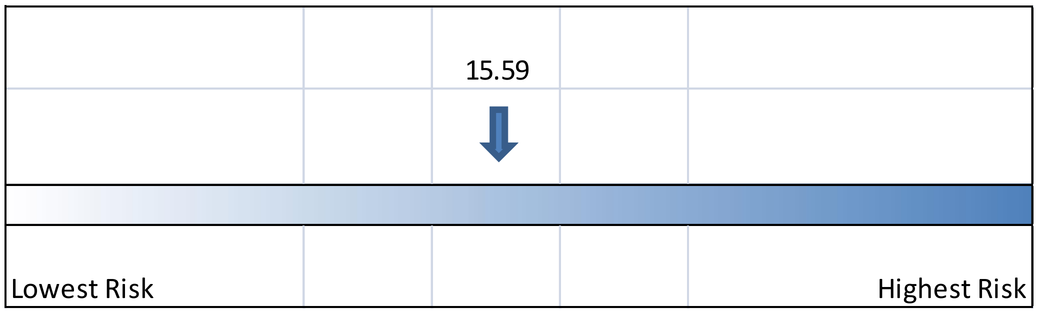
5. Keeping the criteria outlined in the introduction above in mind, would you recommend other risk indicators? If yes, please explain and supplement your recommendations with data/analysis wherever possible.

Comments

While in our view standard deviation is the appropriate basis for determining risk we believe the presentation would be more meaningful to investors if the value were presented together with a labeled scale, as illustrated below.

Example:

Canadian Equity Growth Fund (standard deviation)



We urge the CSA to consider moving dramatically away from subjective nomenclature and toward more objective relative measures which place the fund's actual standard deviation statistic on a scale for investors to compare relative to other funds.

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.

Comments

As the CSA submits in its Proposed Methodology, standard deviation is well known and established, simple to calculate and provides a consistent risk evaluation for a broad range of investment products. However, it is not without its flaws and relying solely on its ease of use or calculation will not provide investors the most meaningful measure of risk of capital loss for a prospective investment.

Standard deviation relies on historical price movements without discerning between negative and positive movements to derive a "rear view look in the mirror" picture of volatility. As a measure, it tells investors nothing about future price or NAV per unit volatility and offers no insight into the probability of future losses.

We note, with great interest, that the CSA studied 15 risk indicators in its research. We urge the CSA to provide industry participants with the analysis as well as the pro and con conclusions for each of these measures. We believe investors would be better served if additional risk indicators were made available to them. Investors who appreciate the value of advice will benefit from their advisors' analysis of risk in the preparation of portfolio investment recommendations. Also, investors who do their own analysis without the benefit of a professional investment advisor, ought to become educated about the science of risk beyond standard deviation. For all investors, relying on one single measure of risk is neither wise nor advised. Therefore, we urge the CSA to consider additional risk measures.

Value at Risk (VaR) and Conditional VaR measure the dollar-loss expectation that can occur within a portfolio or investment over a specific time frame at a certain probability. Measured on a monthly interval basis, VaR can provide investors valuable information about the potential to suffer a significant loss of capital measured at a certain probability level. These VaR statistics could be measured relative to other investments to help investors make informed investment decisions. To note, similar to standard deviation, VaR has its own flaws as do all measures of risk. Therefore, offering a few risk or volatility statistics such as Drawdown, Var, StdDev or Sharpe would provide investors the necessary data to make properly informed investment decisions.

It is important to note that the CSA has already mandated certain changes to Fund Facts which will be fully rolled out by May of 2014 for all funds which, in part, require managers to display the best and worst 3 month performance numbers along with the year by year returns for each series of each fund. This information is conceptually similar to the VaR measure noted above.

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.

   Comments

   We agree that using monthly data is appropriate for calculating risk and volatility measures. We do not agree that it is necessary to use these measures in a monthly two-test methodology in order to achieve improved disclosure. Performing only the Proposed Methodology's second test on a semi-annual basis would yield results that are just as meaningful and reduce significantly the disruption that may occur for borderline funds which may move from category to category more frequently if the test is applied monthly.

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.

   Comments

   While we appreciate the CSA's explanatory note regarding the preference for a 10-year data period, we believe the current 3 and 5 year measures proposed by the IFIC Risk Methodology are more appropriate. The statistical benefit derived by using a much longer 10–year measurement period is marginal at best. However, the longer measurement period will mean significantly more funds will rely on a reference index proxy for volatility rather than using actual data to support the risk rating. The sooner the fund can rely on actual data, the more valuable the derived risk rating will be for investors as it will be based on real data not a proxy for that data.

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.

   Comments

   We believe one uniform approach should be adopted for all series/classes of funds.

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.

   Comments

   We agree with the use of a reference index in absence of sufficient historical statistical information. As noted above, we are of the view that the sooner fund managers can use actual data instead of reference data, the better served investors will be. We agree with the list of the five required criteria points as the basis for the selection of a reference index.

   We do not agree with one of the supplementary principals identified in Appendix A – section 6. *Use of reference index data*:

   - *contain a high proportion of the securities represented in the fund's portfolio with similar portfolio allocations*;

   We believe this will impose an unreasonable constraint on the selection of the reference index.

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.

   Comments

   IPC's greatest concerns with respect to the Proposed Methodology relate to the risk bands. With respect to the proposed number of risk bands, the introduction of the 6th category of "Very High" is troublesome. Considering that the MFDA and IIROC dealers have designed their New Client Application Forms and that industry vendors have designed their systems without consideration for a "Very High" category of risk, the downstream impacts will be significant. At the very least, investment dealers will require sufficient transition periods in order to prepare for these changes. We suggest a period of 12 months for the system and paperwork adjustments and additional 12 to 18 months for to account for the significant repapering requirement.

The greatest impact of the Proposed Methodology is a bi-product of the differences in the risk band category nomenclature associated with certain ranges. For example, the “risk categories and corresponding standard deviation bands” table displayed as part of the *Proposed Methodology features* demonstrates that the majority of funds in the existing IFIC risk category Medium (11% to 16%) will now be rated Medium to High (12% to 18%).

Risk Category	CSA Proposed Bands	IFIC StdDev Bands	Overlap
Low	0-2.0	0-6.0	0-2.0
Low to medium	2.0-6.0	6.0-11.0	nil
Medium	6.0-12.0	11.0-16.0	11.0-12.0
Medium to High	12.0-18.0	16.0-20.0	16.0-18.0
High	18.0-28.0	>20.0	20.0-28.0
Very High	>28.0		nil

Only those funds with a standard deviation from (11% to 12%) will remain rated as Medium.

The Explanatory Note provided in Annex A indicates that the CSA used a survivorship bias-free dataset of 10-year standard deviation rolled monthly from 1965 to 2012 for the Canadian fund universe (about 2,200 fund series were included) from Morningstar Direct. However, the CSA has not explained what led to the conclusion that the ratings associated with their bands were more appropriate than those currently used in the IFIC guidelines. Instead of allowing the industry registrants to reach their own conclusions about the CSA’s thinking, we urge the CSA to provide an explanation in this regard.

In its explanatory notes to the Notice, the CSA has indicated “*An initial risk band adjustment that results in a fund shifting to a higher risk band should not generally be interpreted as meaning that the fund has a greater degree of risk than was previously the case*.” We believe here, that the CSA has significantly underestimated an investor’s reaction to the changes. Investors will be worried about past risks and/or losses incurred and will want a reassuring explanation of the changes if not full dispensation for any past or future consequences resulting thereof.

An initial analysis conducted by Canadian mutual fund managers indicates that between approximately a third and 90% of existing mutual funds (depending on the sponsor) would have their risk ranking reclassified under the Proposed Methodology without any change in their portfolio investments. This has significant potentially negative ramifications in that it would mean that the holdings in many client accounts would suddenly be inconsistent with the “Know Your Client” (KYC) information maintained by the servicing MFDA or IIROC dealer. This would require the advisors who service those clients to review these accounts and consult with clients as to whether their KYC information should be revised to conform to their holdings or to rebalance their holdings to reflect their KYC. This can only cause confusion on the part of clients and would not be a useful exercise for anyone involved, since nothing will have changed except the risk ranking of holdings in the account. Worse, this may cause a client to consider moving assets from equity mutual funds to fixed income mutual funds for the sake of maintaining alignment with their KYC parameters potentially setting themselves up for significant losses by being exposed solely to an interest rate sensitive asset class.

We believe that the current bands proposed within the IFIC Risk Methodology are more appropriate. We know, for example, that most IIROC dealerships would generally rate a large capitalization stock on the S&P TSX Composite Index as a Medium risk security for suitability assessment purposes. That assessment is rarely, if ever, disputed by clients or IIROC. Therefore, if one stock is commonly accepted as Medium risk, it is not logical to rate the entire, broadly diversified S&P TSX Composite Index as Medium to High.

As noted in response to question number 5 above, we urge the CSA to consider moving dramatically away from subjective nomenclature and toward more objective relative measures which place the fund's actual standard deviation statistic on a scale for investors to compare relative to other funds. This would remedy the impacts and challenges with the introduction of the 6^{th} risk category; "Very High".

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.

    Comments

    We believe there is no advantage to monitoring fund risk more frequently than semi-annually. There is only an insignificant improvement in statistical accuracy through a more frequent monitoring which is of minimal benefit to investors. However, the increase in resources, time and effort to compute the two proposed tests monthly is not insignificant. The more frequent testing may require more frequent changes to risk ratings which may lead to investor confusion and possible mistrust in the information. Also, we are of the view that monitoring and calculating the data for the Proposed Methodology's test number 2 only will yield results that are just as effective and helpful to investors.

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

    Comments

    We believe the proposed 10 year period seems arbitrary and unusually long relative to other record retention requirements within the investment industry. We believe that a 7 year retention period is more reasonable.

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?

    Comments

    As noted above, the roll out of the Proposed Methodology will cause significant impact to fund managers, dealers and investors. We urge the CSA to reconsider its approach on this matter in favour of working with IFIC to blend the best features of the Proposed Methodology into the current IFIC Risk Methodology Guidelines.

We urge the CSA to consider the recommendations we've made in response to question 11 regarding the subjective nature of nomenclature and in response to question 12 regarding the frequency of fund manager testing.

Conclusion

We thank you for the opportunity to submit our comments in response to the above-noted notice and trust that our comments will be helpful to the CSA in refining the Proposed Methodology. We would welcome the opportunity to comment on a revised draft of the proposal prior to any publication of a CSA discussion paper on fund risk methodology. Should you have any questions or desire to discuss the proposal or our response, please feel free to contact Rick Kenney, VP, Risk Management, IPC Portfolio Services at (905) 212-2436 or by email at richard.kenney@ipcc.ca.

Kindest regards,

Christopher S. Reynolds
President & CEO, Investment Planning Counsel Inc.