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David Fieldstone Submission

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (FF) and ETF Facts - Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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For all of those in interest and concerned:

I appreciate the opportunity to comment on the fund risk rating methodology. Judging from the letters already posted. it's obviously a controversial methodology.

I think for most people saving for retirement, risk is the chance of losing money - the bouncing around of monthly returns for someone investing over 10, 15 or 20 years is a useless statistic further made useless with ill- defined words with no numerical or other context . In fact historical monthly volatility of returns really does not translate to long term risk in my mind at all. Not only is it useless in portfolio construction but it is actually misleading and harmful. If the CSA is going to authorize this methodology at least the Standard deviation value should be cited in numerical terms. The "adviser" can then meaningfully interpret this for the client.

Also, it seems to me to be a deception, when a Fund can advertise a Low to Medium risk rating when half the data or more are derived from an index selected by the fund manager rather than actual data. Fund Facts (FF) should prominently warn the investor that this is a rating only partially made up of real fund numbers over the 10 years. I would much rather see the worst 12 months return over the 10 years even if it was all an index closely correlated with the fund. That would be useful. And by the way, why not provide an index benchmark, so an investor could compare the actively-managed fund's performance to a passive index?

The " How risky is it? Section in Fund Facts deals with volatility. No matter how many times I read it it comes across as gibberish. What I want to know is what exactly are the risks in the fund? How much can I lose?

The volatility rating is based as I understand it, on the well behaved Normal distribution. Skewness and Kurtosis are important because few real world investment returns are normally distributed as assumed by the CSA. A rating based on the calculated standard deviation is therefore quite possibly inaccurate. An investment's skewness and kurtosis measure how its distribution differs from a normal distribution and therefore provide an indication of the reliability of predictions based on the standard deviation. As Figure 6 in this article *Assessing Skewness and Kurtosis in the Return Distribution* highlights, two investments with very different distribution profiles can have the same mean and standard deviation. Therefore, it is useful to consider other methods for predicting returns. This is why I take the proposed risk rating methodology with a grain of salt. https://www.evestment.com/resources/investment-statistics-guide/assessing-skewness-and-kurtosis-in-the-return-distribution/

From the perspective of a retail investor the word **Medium** risk is misleading. If you look at a random selection of Canadian and US Equity Funds, the losses in 2008 ranged from 32-48 %, yet they are rated Medium risk. The word **Medium** risk is deceiving and could easily destroy a RRIF account. Why not use a number scale or colour code? I note that Europe uses 7 bands; the original CSA proposal used -6-. So why is 5 now an optimum number, since it means there will be excessive clustering around Medium risk?
Bond mutual funds make up over 40% of my portfolio - virtually all are rated LOW risk. What happens if interest rates rise? And then there are the "junk bonds".

The other issue I have with the risk rating is the fact that nearly half the cost of buying an equity mutual pays for "advice". Adviser risk is a risk at least as big as any risks from the person managing the fund. There should be a clear bold warning in Fund Facts that the "adviser" or whatever title they choose for themselves, is in a conflict- of- interest.

There is legion of research clearly showing that this conflict actually causes harm to the investor. No beating around the bush in the wording. This would encourage investors to ask more questions, do more research, and/or find another adviser. The United States SEC mandated disclosure in the Summary Prospectus is patently more forthright than the disclosure in FF's: "**Payments to Broker-Dealers and Other Financial Intermediaries. If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."**

Given the nature of FF's, I think an Investor Users Guide is critically needed to obtain the potential benefits. It could also explain the ideas behind the fund risk rating in simple language, and show investors how to use each data block in FF's for better investment decision making. It would furthermore make it clear that the fund rating has limitations and encourage investors to ask advisers more questions about fees, risks and returns.

I do not find the section -How risky is it? - of much value, and I would never use it in my decision making. The G&M, Morningstar, and Fund-library offer better detail and insight – online - ncluding the important ability to compare against a benchmark.

Because it deceives - I cannot support this methodology no matter how much the rules surrounding it are tuned up as a result of this consultation. It is a matter of basing - on unsubstantiated statistical assumptions, surrogate numbers, undefined word(s) standing in for standard deviation which itself is not understood by retail investors , goes against the wisdom of the world's greatest investors, doesn't actually identify the major risks of investing in the fund and in the end provides a misleading rating.

Risk is a huge concern for seniors/retirees. The CSA can and should do much better in disclosing it. Just look at the troubling OBSI complaint statistics. You need to think like an investor not a lawyer or mathematician when choosing a risk disclosure approach for unsophisticated investors .

As a lawyer, I am also concerned that pre-sale delivery of FF's will be deemed to be in full compliance with applicable securities law and that such use offers the dealer/fund manager a full defence to any claims of misrepresentation relating to the serial use of misleading risk and other disclosures. It is essential that the CSA not place investors in this position in the way it frames FF's as a decision tool.

Fund Facts is a step in the right direction and a 4 page document is more likely to be read by retail investors than the "Simplified" Prospectus. I sincerely hope that both regulators and the industry will view Fund Facts as a critical disclosure document affecting the life savings of over 10 Million Canadians . In particular, Fund Facts needs to improve its risk disclosure and suitability guidance . The guidance should be aimed squarely at ordinary Canadian investors. The fact that SD is in common use and easy to calculate is not relevant to investor protection if it's unfit for use.

I hope this feedback from Main Street is useful to you.

I grant permission for public posting of this Comment letter.

Sincerely,

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