Borden Ladner Gervais LLP
Scotia Plaza, 40 King St W
Toronto, ON, Canada M5H 3Y4
T 416.367.6000
F 416.367.6749
blg.com

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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Delivered to:

The Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, ON M5H 3S8
comments@osc.gov.on.ca

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
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comments *CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts Proposed Amendments to National Instrument 81-102 Investment Funds and Related Consequential Amendments* – published for comment December 10, 2015

We are pleased to provide the members of the Canadian Securities Administrators (CSA) with comments on the proposed amendments to the various instruments as published for comment in the above-noted CSA Notice. Our comments are those of individual lawyers in the Investment Management practice group of Borden Ladner Gervais LLP and do not necessarily represent the views of BLG, other BLG lawyers or our clients.

We are overall very pleased with the proposed rule amendments which took into account the many substantive comments that were made on the original proposals published for comment

with CSA Notice 81-324 in December 2013. Our more substantive comments were addressed by the proposed amendments to the various instruments.

Overall, as we noted in our December 2013 comment letter, we understand the policy rationale that would lead the CSA to consider mandating one standardized method for disclosing the risks associated with mutual funds. While we have no particular expertise on the specifics of the various different methodologies, we understand that standard deviation is generally considered to be a good proxy for measuring the volatility of a mutual fund, which may be perceived of as "risk" – and we generally support the concept of the CSA choosing this one methodology and requiring all mutual funds to base their risk assessment on that measurement methodology (although we note that some mutual funds and their managers may wish to use a different methodology than one that measures "volatility" having regard to the specialized nature of the mutual fund – please see our comments 6 and 7 below).

We have the following comments on the proposed rule amendments.

Application to ETFs

1. We have no issue from a policy perspective with the CSA expanding the investment risk classification methodology to ETFs, although we note that the amendments as they apply to ETFs cannot come into force until such time as the ETF Facts document and rule proposals are completed. We urge the CSA to clarify that an ETF does not have to immediately amend their ETF Facts document (many already use a summary document) in order to disclose their investment risk (according to the new rules), until the next renewal, provided there is at least six months between the coming into force of the amendments and the next renewal. Anything else would be burdensome and unnecessary having regard to the length of time both the ETF Facts document and the risk methodology have been in development by the CSA.

Need for Careful Consideration of Transition to Any New Regime

2. It is unclear what the CSA propose by way of transition. Similar to our comment above, we urge the CSA to clarify explicitly that the first annual review of the investment risk (according to the new methodology and rules) must take place at the time of the next renewal of the funds' prospectuses, provided that there is at least **six months** between the coming into force of these amendments and the funds' next renewal. As we pointed out in our December 2013 comment letter, in thinking about transition, it is of utmost importance that the CSA keep in mind:

   (a) It is burdensome for mutual funds and their managers to revise the templates used to create Fund Facts, as well as for dealers and advisors to understand the changes made to the Fund Facts so they can use them with their clients.

   (b) Fund managers will need to institute systems for calculating and monitoring, and keeping records of same, regarding the new methodology. This takes time and

resources, and when factoring in other regulatory changes, needs to be implemented thoughtfully.

(c) It will be important for the CSA to monitor the dates when most funds renew their prospectuses – being the spring and into the summer months – if the rule comes into force too closely with this renewal season, these fund managers will have insufficient time to prepare for compliance with the new rules and should be provided with longer transition timing in order to lessen the regulatory burden. To be clear, we recommend a longer transition timing for all fund managers regardless of renewal of their prospectus.

(d) The ongoing work within the industry to comply with CRM-2 requirements that came into force in July 2013. These requirements impact all registrants – including fund managers and distributors of mutual funds. Effective implementation of CRM-2 absolutely must take precedence to the CSA's efforts in this area, given the nature of the significant changes required by the CRM-2 requirements, as well as the continuing uncertainty on aspects on how to apply certain of the requirements and avoid unintended consequences.

(e) We also point out that the recent choice of the CSA of mid-month dates, such as May 13 and June 13 (Fund Facts) and July 15 (CRM-2), has significant implications for industry participants and we urge the CSA to return to using calendar month-end dates, as well as dates that have a logical linkage to the new requirements and common industry timing, in order to ease transition.

Our emphasis on the need for an appropriate transition period, as well as an adequate period of time to implement any new rules is coloured by our experience with the amendments to the Fund Facts requirements that became effective in September 2013, which we described in our December 2013 comment letter. We strongly urge a recognition of the additional regulatory burden that resulted from the transition required by that rule to avoid the same issues with the implementation of these rule amendments.

Monitoring of Standard Deviation

3. We are pleased that the CSA pulled back from requiring monthly monitoring of standard deviation calculations for each mutual fund. An annual monitoring, in conjunction with the renewal of the mutual funds' prospectus, appears to us to be the maximum that should be mandated, with ad hoc review in the discretion of the fund manager as a result of material changes to the fund that could impact its rating. This is consistent with current industry practice and the IFIC Guidelines and makes logical sense, given that the renewal must contain updated information about the mutual funds and all other information is updated annually.

We are concerned however that the amendments to the Fund Facts Form (in Appendix C to the CSA Notice) will necessitate a review of the investment risk of each fund at any updating of Fund Facts documents outside of the annual prospectus renewal ("risk classification must be within 60 days before the date of the Fund Facts document"). We

urge the CSA to specifically explain that this does not mean that fund managers must review and update the calculation at the time of filing of an amendment to the Fund Facts (which is necessary in conjunction with a material change to the Fund which is unlikely to impact the risk rating of the fund), but they should consider whether the change would alter the risk rating. The annual review is sufficient in our view and is the maximum that should be required.

4. We agree with the concept that a fund manager should determine the risk rating of the Fund as a whole, rather than series by series and commend the CSA for keeping this concept in the proposed amendments.

Reference Index for Mutual Funds with Less than 10 Year History

5. The CSA propose guidance about the appropriate "reference index" to use if a mutual fund does not have a 10 year performance history. We continue to urge the CSA to consider the following issues, among others, that may be raised by industry participants that are more familiar with the methodology to calculate standard deviation:

   (a) We consider that the fund manager should have discretion to choose a reference index that it considers appropriate – it is not necessary to mandate specifics around this issue, given the fund manager's overall fiduciary responsibilities. If the CSA feel they need to be prescriptive (and we recommend the CSA explain why they need to be prescriptive), we question the CSA's guidance in Item 4 of Appendix F to NI 81-102 about the reference index.

      (i) How can the returns of an index be highly correlated to the returns of the mutual fund, when the mutual fund does not have any returns (a new fund) or does not have the returns for the same time periods as the index? Also, if a fund is actively managed, it may not be "highly correlated" to an index. Most actively managed funds seek to outperform or perform differently that their benchmark index.

      (ii) How will a fund manager determine whether or not an index will have a "historic systemic risk profile" highly similar to the fund – what does this mean? And how will this apply to a new mutual fund?

      (iii) How can a fund manager determine whether the index "has security allocations" that represented invested position sizes on a similar pro rata basis to the mutual fund's total assets. How will this apply to a new mutual fund?

   (b) In our view, a fund manager must be able to use its discretion to use an appropriate reference index, even where a mutual fund has 10 years of performance data, in cases where there has been a fundamental change to the mutual fund and/or for any other reason the fund's past returns are not representative of the fund's current attributes. Item 5 of Appendix F does not clearly explain this or even reference it.

(c) We also urge the CSA to explicitly permit the fund manager to use its discretion to determine the risk rating for a fund with less than 10 years performance history, where the reference index may suggest a higher volatility, but the manager is able to show qualitatively and quantitatively that the fund belongs in a lower category.

6. We continue to consider that additional thought should be undertaken regarding “indices” and the CSA’s requirements for such in general – NI 81-101 mandates comparisons to an index in Fund Facts documents, as does NI 81-106 for continuous disclosure purposes and now Appendix F to NI 81-102 for risk classification purposes. In each circumstance, the definitions and guidance is slightly different – and we do not understand why that would be the case, particularly since the differing rules could result in a fund being compared to a different index (pursuant to the NI 81-106 documents and the fund facts) from that used as a reference index for risk circumstances. We consider the same (streamlined) guidance as to an appropriate index should be the same for all three usages of same.

Need to Allow for Fund Manager Discretion

7. The CSA’s proposed methodology uses a quantitative process and does not permit any deviation, exercise of discretion or qualitative analysis by the fund manager, unless it decides to move the risk rating up to a *higher* risk classification. There may be many non-measureable risks, such as portfolio manager changes, relative liquidity of certain investments or a sector specific or global financial crisis, where discretion of the fund manager will be important to provide an accurate depiction of risk to the potential investors. We believe that fund managers should be encouraged to apply discretion prudently to raise or lower the risk, the latter we understand the CSA’s proposals would not permit. In our experience fund managers are generally in the best position to assess non-measurable or unquantifiable risks and how they apply to a fund.

8. We urge the CSA to recognize that there may be speciality mutual funds for which standard deviation is not the correct measurement of risk – in that volatility is not the right measurement of risk to reflect the actual risk profile of the mutual funds.

   Precious metals mutual funds, including mutual funds that invest in gold, are the best example of this issue, given that the price of the underlying assets are inherently volatile. Volatility is not an appropriate measure of risk for gold because it has intrinsic value (i.e. it does not have the potential to have NIL value like a stock or bond). Gold also provides protection against falling equity prices and has low historical correlation with other asset classes and therefore represents an alternative holding as part of an overall wealth protection strategy.

   We recommend that further consultation be conducted and the proposed rules acknowledge the circumstances when a fund manager may wish to use another appropriate measurement of risk. At the very least, the rules should recognize the inapplicability of standard deviation to mutual funds that invest in precious metals and permit the fund manager to use a measurement that is more tailored to the specific mutual fund. We note that this result would be permitted by the IFIC Guidelines.

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We thank you for allowing us the opportunity to comment on the proposals set out in the CSA Notice. Please contact any of the following lawyers at the contact details provided below if the CSA members would like further elaboration of our comments. We, together with other BLG lawyers who have considered the proposals, would be pleased to meet with you at your convenience.

Rebecca Cowdery	Lynn McGrade	Francesca Smirnakis
416-367-6340	416-367-6115	416-367-6443
rcowdery@blg.com	lmcgrade@blg.com	fsmirnakis@blg.com

Yours very truly,

BORDEN LADNER GERVAIS LLP

Borden Ladner Gervais LLP

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