PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
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March 9, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumers 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

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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The Secretary
Ontario Securities Commission
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Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts – Proposed Amendments to NI 81-102 Investment Funds and Related Consequential Amendments

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The Portfolio Management Association of Canada ("PMAC")[1], through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to respond to the proposed amendments for Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts (the "Proposal"). PMAC has generally been supportive of the CSA's direction on mutual fund risk classification and the use of standard deviation. We are also supportive of some of the key changes from the 2013 proposal including the elimination of the six-category risk scale presented in the 2013 Proposal, to the standard five-category risk scale from low to high currently in the Fund Facts and in the proposed ETF Facts.

[1] PMAC was established in 1952 and currently represents over 220 investment management firms that manage total assets in excess of $1.4 trillion. PMAC Members are registered portfolio managers with the Canadian securities regulators as well as, in many cases, registered investment fund managers and exempt market dealers. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

Proposed Reference Index

Our main concern with the Proposal is the proposed reference index for mutual funds and ETFs without a 10 year return history (the "Proposed Reference Index"). In our view, many investment fund managers, who have concentrated portfolios or who are true active managers, will struggle with finding appropriate indices for their funds in light of several of the principles listed in the Proposed Reference Index. For some of our Members, the only way to comply with the principles included in the Proposed Reference Index will be to engage an unaffiliated third party to create appropriate reference indices. This would be prohibitively expensive and complex. In addition, as the regulators are aware, ten year return data does not exist for a significant portion of mutual funds/ETF's in Canada. By substituting an index for actual fund performance, the disclosed risk of the fund may be overstated or understated and this problem will be greater the younger a fund is because the younger the fund the more years of reference index performance it will have to use. In many cases, the use of a reference index won't necessarily provide an accurate representation of the fund's risk.

Our Members have expressed concerns with specific principles. For example, principle (c) *which requires the reference index to "contain a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations*" is problematic because if interpreted to mean only if the mutual fund has a low active share relative to a particular proposed reference index will that reference index be acceptable, for some of our Members, their funds would not have an appropriate active share ratio and it would be impossible to meet this principle. Similarly, principle (d), which requires the reference index to "*have a historical systemic risk profile highly similar to the mutual fund*", will also be problematic for some actively-managed funds because it may not be possible to come within the "beta" range. We believe the CSA should re-consider the inclusion of these principles and others potentially for similar reasons.

We also strongly believe that certain of the principles require further clarification. For example, principle (b) "*has returns highly correlated to the returns of the mutual fund*" is not clear. We query the meaning of "highly correlated" in the context of the Proposed Reference Index and note that there is no current widely accepted industry standard as to how to establish high correlation. Further clarity as to what is expected here would be beneficial.

We also note that the Proposed Reference Index also does not take into account the permitted investments that many 81-102 mutual funds are permitted to undertake (i.e. short selling, derivatives, etc.). These are not accounted for in any of the reference indexes that are available.

Indices Used in the Management Report of Fund Performance (MRFP)

The Proposal indicates that an index or indices used in the management report of fund performance (MRFP) in Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* can also be used as a proxy to determine the investment risk level of the mutual fund, if the index or indices meet the principles set out in the Proposed Methodology. While for some active funds, the use of the index used in the MRFP may be acceptable, for many funds it will not be as the Proposed Reference Index requires far more to be captured. For example, Instruction (1) of Item 4.3 of 81-106F1 provides that an appropriate broad-based index is one that is administered by an unaffiliated entity (unless it is widely recognized and used) and which has been adjusted to reflect dividend reinvestments. The principles in the Proposed Reference Index go far beyond this.

Similarly, Instruction (3) of item 4.3 of 81-106F1 states that if one is going to optionally compare oneself to a financial or narrowly-based securities index then that index must reflect the market sectors in which the fund invests or provide comparatives to the performance of the fund. These criteria are far more manageable and easier to comply with than the principles set out in the Proposed Reference Index. For example, the principle listed under paragraph (c) of the Proposed Reference Index indicates that the index must contain "a high proportion of the securities represented in the mutual fund's portfolio with similar portfolio allocations". Unless a fund is an index fund, we do not believe that any fund can find an index that meets that principle unless it is customized.

Recommendations

We believe the Proposed Reference Index should be more flexible to ensure funds can meet the listed principles. We also believe the principles need to be better defined and clearly understood. For this reason, we recommend the CSA consider whether certain criteria should be removed from the Proposed Reference Index to ensure investment fund managers can meet the principles without compromising the accuracy and reliability of the fund's risk rating. In this regard, we also believe the principles need to be less prescriptive and less onerous. We recommend the CSA publish guidance for comment to provide more details and clarity around what is expected in meeting the principles in the Proposed Reference Index. This would enable the industry to clarify its interpretation of certain concepts referred to in the principles and would level the playing field in ensuring all fund managers are interpreting and applying the principles in a consistent and appropriate manner.

While we believe that generally, the Proposal will provide for greater transparency and consistency, and enable investors to evaluate and compare the investment risk levels of mutual funds and ETFs, certain aspects of the Proposal, namely the Proposed Reference Index, is problematic for certain fund managers and must be revisited to ensure it will actually accomplish was it is designed to do and meet the policy objectives of the regulators.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@portfoliomanagement.org) at (416) 504-7018 or Julie Cordeiro (jcordeiro@portfoliomanagement.org) at (416) 504-1118.

Yours truly;

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