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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

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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

I am pleased to again have the opportunity to share my input on this important issue. For background, HighView Financial Group is the brand under which we operate our business.

HighView Asset Management Ltd. (“HighView”) is registered in Ontario, Alberta, British Columbia and Saskatchewan in the category of Portfolio Manager. HighView design portfolios for affluent families and institutions.

HighView is in a fiduciary relationship with each client. Central to our fiduciary duty is the notion of transparency – both in the illustration of risk before clients formally engage us and via ongoing reporting after they become clients. This is important to us. In our view, risk is a highly personalized concept. Accordingly, we dedicate significant thought and resources to make sure that risk is measured in ways that are meaningful to clients and communicated/illustrated in ways that they grasp to empower them to make fully-informed investment decisions.

Standardized method to measure and illustrate risk

As noted in [my submission two years ago](#) on this issue, we strongly support a standardized risk measurement. This facilitates the comparison across different products and eliminates inconsistencies in the status quo. Since 10-year standard deviations (SD) are more stable than 3- and 5- year SD measures, the requirement for 10-year SD measures is a significant improvement.

Standard Deviation and the CSA’s proposed risk communication

The CSA note that SD’s “*calculation is well known and established*”¹ – a claim that the industry repeatedly trumpeted in its submissions to the 2013 consultation supporting the status quo. I agree with this claim if we’re talking about the investment industry and academia. But this measure is supposed to inform the investing public. And neither the CSA nor the investment funds industry has demonstrated that retail investors understand standard deviation (the calculation or the output). More importantly, the CSA has not tested whether investors can take the five-point descriptive risk scale and equate it with their own views of risk.

Assuming for a moment that SD is indeed well-known and established among retail investors, I note that neither the status quo nor the CSA’s proposed method actually discloses SD to investors. It simply takes the SD measure and interprets it for people using the five-point

¹ Page 3 of the CSA’s Notice and Request for Comment dated December 10, 2015:
https://www.osc.gov.on.ca/documents/en/Securities-Category8/ni_20151210_81-102_mutual-fund-risk-classification-methodology.pdf

descriptive scale. And the CSA has not tested if the very investors they aim to protect and inform can meaningfully interpret the five-point scale.

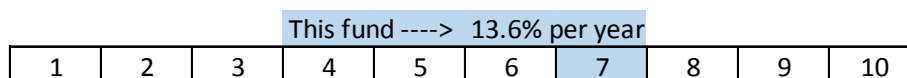
In my view, the CSA's proposed risk illustration and communication to be used in Fund Facts and ETF Facts will not communicate the intended information to end investors. The CSA proposes calculating a fund's trailing 10-year annualized standard deviation, applying the number to a qualitative five-point scale and illustrating the scale on Fund Facts and ETF Facts documents. An example of the chart and accompanying text is shown below.



This rating considers how much the Fund's returns have changed from year to year. It doesn't tell you how volatile the Fund will be in the future. The rating can change over time. A fund with a low risk rating can still lose money. For more information about the risk rating and specific risks that can affect the Fund's returns, see the Risk section of the Fund's simplified prospectus.

Consider the case of a Canadian Equity Index ETF. Its trailing 10-year standard deviation at February 29, 2016 was 13.56% annually². This would result in a risk illustration identical to the above sample – i.e. medium risk – under the status quo and the CSA's proposed method.

If in fact that the CSA is convinced that SD's calculation and output are well known, then a numerical scale – with the actual number disclosed – is preferable since it allows each individual investor to make the interpretation. This could look something like the sample illustration below. At a minimum, show the SD number on the existing descriptive scale.



² Computed using monthly total returns based on closing market prices. Raw monthly standard deviation – i.e. computed on monthly returns and not annualized – was 3.91%.

Standard deviation as a risk measure

Standard deviation is a meaningful statistic if used properly. I have long held it out as [a measure of behavioural risk](#)³. And our firm uses it in two ways – as a statistic alongside downside risk metrics; and as an input in risk-adjusted return metrics. But we never use it as the primary statistic to communicate risk. It's a supplemental statistic.

Continuing with the aforementioned example of a Canadian Equity Index ETF, its standard deviation is not terribly meaningful even to those who understand it without also providing the arithmetic average return over the measurement period. Investors can only translate a SD measure into a range of possibilities if they are also provided with the arithmetic average. The table below illustrates this idea.

	Monthly	Annual
Standard Deviation	3.91%	16.68%
Arithmetic Average	0.38%	7.04%
Average – 3SD	-11.35%	-43.00%
Average + 3SD	12.11%	57.08%

The Canadian Equity Index ETF had an average monthly return of 0.38% with a standard deviation of 3.91%⁴. Both are monthly figures – i.e. not annualized. Taking the average and triple the SD, a range of expectations can be formed. In this example, monthly returns might be expected to range from -11.35% to a high of 12.11%. The “Annual” column above illustrates the same math using annualized returns.

Investors have wildly diverse levels of investment knowledge and experiences. Accordingly, this approach is challenged by having to explain these statistical terms in practical and comprehensible language. For this reason, I believe that using intuitive risk metrics is an improved approach.

³ See <http://www.highviewfin.com/blog/volatility-measures-behavioural-risk/>

⁴ Measured using the 120 monthly total returns through February 2016

Intuitive risk metrics

No single statistic can fully capture investment risk. But if I were to choose a single metric to measure and illustrate risk for retail investors it would be *Maximum Drawdown* and *Recovery Time*. Continuing with our Canadian Equity Index ETF example, we've seen that its risk would be rated as "medium" under the existing and proposed methods.

Using the same series of monthly returns that are needed to calculate SD (required under the current and proposed methods), one can calculate *Maximum Drawdown* (shown below as Biggest Drop) and *Recovery Time*⁵. The table below illustrates these figures for our Canadian Equity Index ETF example. And ideally this sort of illustration should be paired with a frequency – i.e. this kind of drop has happened every eight years in the past – for complete context.

Biggest Drop	-48.0%
Peak to Trough (months)	25
Trough Thru Recovery (months)	39

Another key ingredient to making this kind of risk measure work is the mandatory inclusion of at least one bear market – regardless of how long ago it occurred. While Fund Facts' use of rolling returns partially addresses the illustration of downside risk, even the CSA's requirement to use ten years of historical data will often fail to capture any bear markets. The above statistics can be calculated using the same monthly data already used for both the status quo and the CSA's proposed method. Given that every fund company I know uses a professional portfolio management system, these statistics should not be burdensome to calculate and maintain.

This kind of measure will be more stable than the status quo and the CSA's proposed method. As prices rise and SD measures fall, Biggest Drop or Maximum Drawdown are highly stable – only changing when a more severe bear market materializes. When risk is shown numerically and focus on losses, risk ratings don't fall – as has occurred on dozens of funds over the past year.

⁵ Note also that while we split *Recovery Time* into two time frames – i.e. how long to hit bottom and how long to fully recover – this can be combined into a single line item showing the total time spent in loss territory.

Fund risk rating changes

I have been tracking fund and ETF sponsors' risk rating change announcements since last spring⁶. My sample includes 61 mutual funds and ETFs – of which 45 are unique mandates⁷ – for which risk ratings were changed. See **Appendix A** for the full list of risk rating changes covered.

Thirty-five of the 45 unique mandates – or 78% – saw risk ratings fall in the face of rising asset prices. Yet valuation risk increases as asset prices rise. The CSA's requirement to base ratings on 10 years of history will help reduce this effect, but it will remain a problem.

In two short years, the worst bear market of this generation will disappear from the trailing ten-year record. And if another bear market has not occurred in that time, the 2007-08 Financial Crisis will slip out of the 10-year time frame and standard deviations are likely to fall. That's exactly what happened with 78% of the fund risk rating changes I studied. But consider the following statistics from my sample of 45 risk rating changes.

- 24 of the 45 unique mandates have been around long enough to have experienced at least one bear market in the past.
- Nineteen of these 24 funds are now rated as “medium” risk or lower.

	Low Risk Funds	Low-Medium Risk Funds	Medium Risk Funds
# of Funds	10	5	4
Average Bear Market Loss	-21%	-36%	-31%
Average Time Spent under water	3 years	5 years	2 years

⁶ While I've attempted to capture all risk rating changes I cannot be sure that I've succeeded in this regard. Sources include news stories in the public domain and fund company press releases.

⁷ For example, a fund offered as both a trust and a corporation are treated as two funds but one unique mandate.

While I hope that the CSA's proposed method will decrease the kind of *risk category jumping* I've observed over the past several months, the magnitude of decrease is unclear at this point. Moreover, neither standard deviation nor the CSA's proposed risk scale are capable of communicating the simple concept of loss and recovery to retail investors.

I applaud the CSA for proposing a stronger and uniform standard for fund and ETF risk ratings. But I also strongly urge the CSA to consider a more intuitive risk measure prior to making its final decision.

I welcome the opportunity to further discuss this issue and my specific comments with the CSA.

Sincerely,

Dan Hallett, CFA, CFP
Vice-President & Principal
HighView Asset Management Ltd.

Appendix A – Sample of risk rating changes from May 2015 to February 2016

	35	Risk reduction	78% of risk rating changes have been			
	10	Risk increase	risk reductions			
Fund Name	Direction	Previous Risk Rating	New Risk Rating	Risk Rating Method	Last Bear Market Drop	Time Under Water
Franklin Bissett Canadian Balanced	⬇️	Low-to-Medium	Low		-28%	2 years & 4 mos
Franklin Bissett Canadian All Cap Bal	⬇️	Low-to-Medium	Low			
Franklin Bissett Canadian High Dividend	⬆️	Low-to-Medium	Medium		-35%	1 year & 9 mos
Franklin Bissett Dividend Income	⬇️	Low-to-Medium	Low		-25%	1 year & 10 mos
Franklin Quotential Balanced Income	⬇️	Low-to-Medium	Low		-23%	2 years & 5 mos
Franklin Quotential Diversified Equity	⬇️	Medium	Low-to-Medium	Historical Volatility	-44%	5 years & 7 mos
Franklin World Growth	⬇️	Medium	Low-to-Medium		-46%	3 years & 11 mos
Templeton Asian Growth	⬆️	Medium	Medium-to-High			
Templeton BRIC	⬆️	Medium-to-High	High		-52%	still recovering (after 8.3yrs)
Templeton Global Bond	⬇️	Low-to-Medium	Low		-13%	3 years & 7 mos
Templeton Global Smaller Companies	⬆️	Medium	Medium-to-High		-55%	6 years & 3 mos
Sprott Enhanced Equity	⬇️	Medium	Low-to-Medium			
Sprott Enhanced Balanced	⬇️	Low-to-Medium	Low	Historical Volatility		
NEI Select Conservative Portfolio	⬇️	Low-to-Medium	Low	Historical Volatility	-17%	3 years & 6 mos
O'Leary Canadian Dividend	⬇️	Medium	Low-to-Medium			
O'Leary Canadian Balanced Income	⬇️	Low-to-Medium	Low			
O'Leary Conservative Income	⬇️	Low-to-Medium	Low	Historical Volatility		
O'Leary Global Dividend	⬇️	Medium	Low-to-Medium			
O'Leary Emerging Markets Income	⬆️	Low-to-Medium	Medium			
RBC O'Shaughnessy U.S. Growth Fund	⬆️	Medium-to-High	High			
RBC Private O'Shaughnessy U.S. Growth Equity Pool	⬆️	Medium-to-High	High	Historical Volatility	-66%	still recovering (after 9.2yrs)
MDPIM Canadian Bond Pool	⬆️	Low	Low-to-Medium			
MD Strategic Yield	⬆️	Medium	Medium-to-High	Historical Volatility		
MD Precision Moderate Growth Portfolio	⬆️	Medium	Medium-to-High			
Standard Life Diversified Income	⬇️	Low-to-Medium	Low		-17%	1 year & 6 mos
Standard Life U.S. Dividend Growth	⬇️	Medium	Low-to-Medium	Historical Volatility	-33%	5 years & 8 mos
Standard Life Canadian Equity Growth	⬇️	Medium-to-High	Medium			
Standard Life Canadian Equity Value	⬇️	Medium-to-High	Medium			
Manulife Diversified Strategies	⬇️	Low-to-Medium	Low			
Manulife Special Opportunities CI	⬇️	High	Medium			
Manulife China Class	⬇️	High	Medium-to-High	Historical Volatility	-52%	7 years & 8 mos
Manulife Global Real Estate	⬇️	Medium-to-High	Medium		-42%	3 years
Marquest Monthly Pay Fund	⬇️	Medium	Low-to-Medium		-40%	3 years & 5 mos
Marquest Global Balanced Fund	⬇️	Medium	Low		-48%	6 years & 3 mos
Marquest Covered Call Canadian Banks Plus	⬇️	Medium	Low-to-Medium	Historical Volatility		
Marquest American Dividend Growth	⬇️	Medium	Low-to-Medium			
Invesco Intactive 2023 Portfolio	⬇️	Low-to-Medium	Low	Historical Volatility	-20%	1 year & 6 mos
Invesco Intactive Diversified Income Portfolio	⬇️	Low-to-Medium	Low		-18%	3 years & 8 mos
Fiera Capital Bond Class	⬇️	Low-to-Medium	Low	Historical Volatility	-5%	1 year
Symmetry Conservative Portfolio	⬇️	Low-to-Medium	Low	Historical Volatility		
Mackenzie Gold Bullion Class	⬇️	Medium	Medium-to-High		-50%	27 years & 2 mos
Standard Life Canadian Small Cap Fund	⬇️	High	Medium-to-High	Historical Volatility	-49%	2 years & 9 mos
Standard Life Global Bond Fund	⬇️	Medium	Low-to-Medium		-19%	5 years & 11 mos
BMO Equal Weight US Banks Index ETF	⬇️	High	Medium		-19%	still recovering (after 7mos)
BMO Equal Weight US Banks CAD-Hedged Index ETF	⬇️	High	Medium	Historical Volatility	-27%	still recovering (after 7mos)

Multiple versions of funds (i.e. trust, corporate class, series F, series T, series A, etc.) are excluded for brevity. Risk stats are calculated on longer running version. Raw data source: GlobeInvestorGold.com