



March 7 , 2014

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sirs and Mesdames:

Re: CSA Notice 81-324 (Notice 81-324) and Request for Comment *Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts (the Proposed Methodology)*

TD Asset Management Inc. (TDAM) welcomes the opportunity to provide comments regarding the Canadian Securities Administrators' (CSA) publication of the Proposed Methodology. Defined terms have the same meanings as those set out in Notice 81-324.

Summary

TDAM is pleased to provide comments in response to items #10, 12, 13 and 14 which are set out in Annex B to Notice 81-324. Below is a summary of our responses.

- **Reference Index:** We request greater flexibility in the selection of the reference index and/or indices applicable for a fund with less than 10 years of history. We ask that the CSA provide greater clarity regarding the whether investment fund managers (IFMs) may use blended benchmarks, and whether they may use

benchmarks for segmented periods and if so, whether such use must be disclosed in the applicable fund's simplified prospectus.

- **Monthly monitoring test for assessing risk rating changes:** we recommend two refinements to the second part of the monthly test for monitoring risk ratings:
 - permit a 1% “tolerance buffer” above and below each risk band end point, above the “low” category, to minimize the impact of short-term drifting of a fund between two risk bands; and
 - increase the average risk classification calculation period from 12 months to 36 months.

- **Data Retention:** Please clarify the specific data to be retained by an IFM in connection with the calculation of a fund's standard deviation. Also, limit the data retention period to 7 years for consistency with paragraph 11.6(1)(a) of National Instrument 31-103 *Registration Requirements and Exemptions (NI 31-103)*.

- **Transition:** Ensure an orderly transition for IFMs, dealers, advisors and investors by implementing the following recommendations:
 - To address the litigation risk to IFMs, state clearly in the CSA's rule and/or companion policy implementing the Proposed Methodology that 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. This recommendation is intended to reflect that a fund's risk rating prior to the implementation of the Proposed Methodology was not incorrect or misleading.
 - Simultaneously implement the Proposed Methodology for investment funds and functionally-equivalent products, including ETFs, to ensure a level-playing field for products.
 - For prospectus and fund facts disclosure, permit a 6 month transition period (to begin after the conclusion of the RRSP contribution deadline) to allow IFMs to update the risk disclosure in the simplified prospectus and fund facts to reflect the Proposed Methodology and waive the filing fees in connection with the amendments for the disclosure changes.
 - In terms of the potential impact to dealers, advisors and investors, work closely with IIROC and the MFDA to determine a suitable time period to allow dealers and advisors to consider the impact, if any, to investors of holding an investment fund that has experienced a risk rating change as a result of the transition to the Proposed Methodology and if there is an impact, to meet with clients to discuss their holdings in the applicable fund(s). In addition, the CSA and/or SROs should advise that a change in the assigned risk rating resulting from the adoption of the Proposed



Methodology does not mean that the risk of the fund has changed. Furthermore, investors should not necessarily be redeemed out of the particular fund due solely to the implementation of the Proposed Methodology.

- Revise Form 81-101F1 *Contents of Simplified Prospectus* (**Form 81-101F1**) and Form 81-101F3 *Contents of Fund Facts Document* (**Form 81-101F3**) to reflect the CSA's role in setting and maintaining the Proposed Methodology, and to remove reference to the IFM assigning a fund's risk rating based on its own risk classification methodology.
- Finally, we strongly recommend that the CSA maintain a significant role in monitoring, updating and communicating changes regarding the Proposed Methodology to address changing market conditions.

Responses to Issues for Comment

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.*

The Proposed Methodology constrains IFMs in their ability to select a reference index(s) that is reasonably reflective of the investment objective and strategies of a Fund with less than 10 years of history. TDAM has four main points in support of our position. Firstly, a Fund's returns may not be highly correlated to the index because of the Fund's active investment strategies. Secondly, a Fund's portfolio may not may have a high proportion of the securities in the reference index or have similar portfolio allocations due to an active management strategy. Thirdly, a reference index may not be "widely recognized" and available for the period for which the data will be a proxy for a Fund. Finally, the Proposed Methodology, as currently drafted in Notice 81-324, requires a reference index to meet each of the stated criteria. Meeting each of the criteria proves particularly difficult for innovative investment funds where risk management is held out as a defining feature of the mandate, such as low volatility and target return funds. As a result, TDAM requests greater flexibility for IFMs to select the reference index(s) for funds with less than 10 years of history.

To encourage innovation while establishing regulatory standards, TDAM recommends the following criteria for selecting a reference index:

- it is administered by an independent, third-party organization that is not affiliated with the fund, its IFM, portfolio manager or its principal distributor;
- it is publicly or commercially available; and
- it is either (a) available during the period the data for which it will be used as proxy; or (b) if the index did not exist for all or part of the contemplated period, it is a reconstruction or calculation of what the index may have reasonably been

during that period, calculated on a basis consistent with its current basis of calculation by an independent, third-party organization.

TDAM also requests that the CSA provide guidance in the Proposed Methodology regarding the level of disclosure to be included in the simplified prospectus about the selection of the reference index and/or indices applicable for a fund with less than 10 years of history. In addition, please clarify in what circumstances, if any, a change in reference index from what was originally disclosed would constitute a material change. Finally, TDAM seeks clarification as to whether IFMs may use blended benchmarks, and whether they may use benchmarks for segmented periods and if so, whether such use must be disclosed in the fund's simplified prospectus.

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.*

TDAM recommends two refinements to the second part of the monthly test for monitoring risk ratings. The purpose of these changes is to avoid investor and dealer confusion caused by frequent risk rating changes, and to limit the information overload to investors and dealers for risk rating changes that do not change the long-term risk rating of a fund.

- (a) Increase the data time period from a 12-month average to a 36-month average risk classification to minimize and appropriately address the impact of market anomalies on the risk rating of a fund and to limit the frequency of risk rating changes. For instance, if the 12-month average is applied, the TD Canadian Index Fund would have experienced two risk rating changes from March 31, 1998 to January 31, 1999. In particular, TDAM would have had to decrease the risk rating of the fund from "medium to high" down to "medium" leading into a period when the TSX and the Fund experienced a 20% decline in one month. In contrast, if the 36-month average risk classification test was in place the Fund would have maintained its "medium to high" rating for the entire period. TDAM takes the view that longer-term data periods are a more accurate and reliable predictor of the risk rating of a fund where standard deviation is the measure.



TD Canadian Index Fund (12-month average risk classification)

	Date	Monthly Return	10 Year Standard Deviation	12-Month Rating Average
TSX and Fund down over 20%	03/31/1998	6.68%	11.93%	Medium to High
	04/30/1998	1.37%	11.93%	Medium
	05/31/1998	-0.88%	11.90%	Medium
	06/30/1998	-2.76%	11.84%	Medium
	07/31/1998	-5.86%	11.99%	Medium
	08/31/1998	-20.19%	13.67%	Medium
	09/30/1998	1.77%	13.68%	Medium
	10/31/1998	10.58%	14.01%	Medium
	11/30/1998	2.24%	13.97%	Medium
	12/31/1998	2.41%	13.95%	Medium
	01/31/1999	3.65%	13.85%	Medium to High

(b) Permit a 1% buffer at the top and bottom of each band, above the “low” category, to minimize risk rating changes for temporary drifts across risk bands. For instance, if Fund A is rated “medium” and on a monthly basis its standard deviation falls to 5.0, we would not have to lower the risk rating band to “low to medium” to calculate the 12 or 36-month average risk classification. Also, if Fund B is rated “medium” and its standard deviation increases to 13.0 on a monthly basis, we could use the buffer to help minimize temporary drifts and remove the need to file a material change report and amendment. The intention is to minimize the resulting costs (internal and external) by not changing risk ratings for minor shifts in standard deviation scores. Rather, TDAM recommends maintaining a long-term view of a fund’s risk rating based on the reference index and/or indices and market developments.

Risk Category	CSA - SD Bands	CSA - SD Bands with Buffer
Low	0 - 2.0	0 - 2.0
Low to Medium	2.0 - 6.0	2.0 - 7.0
Medium	6.0 - 12.0	5.0 - 13.0
Medium to High	12.0 - 18.0	11.0 - 19.0
High	18.0 - 28.0	17.0 - 29.0
Very High	> 28.0	> 27.0

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

First, we ask that the CSA clarify the specific documentation that must be retained in connection with the calculation of standard deviation. Secondly, given the potential for significant records to be kept, TDAM recommends a 7 year record retention period consistent with paragraph 11.6(1)(a) of NI 31-103.

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?*

In addition to the recommendations set out in the Summary section, we recommend revising Form 81-101F1 and Form 81-101F3 to reflect the CSA's role in setting and maintaining the Proposed Methodology, because while an IFM administers the Proposed Methodology, it is not its own risk classification methodology. Please see the suggested revisions below.

- a) Form 81-101F1 (Simplified Prospectus)
 - Item 9.1(1) and (2) of Part B will need to be revised to explain the Proposed Methodology and the frequency at which the risk rating is monitored by the IFM.

- b) Form 81-101F3 (Fund Facts)
 - Item 4(2) and (3) of Part I will need to be revised as follows:
 - (2)(a): update the risk rating scale to illustrate the 6 risk bands;
 - (2)(b) and (c): state that the risk rating is based on the CSA's Proposed Methodology and remove reference to the IFM assigning a fund's risk rating based on its own risk classification methodology.

Conclusion

Thank you for providing us the opportunity to make comments on the Proposed Methodology. We would be pleased to provide any further explanations or submissions with respect to the matters discussed in this response and would gladly make ourselves available for any further discussion.

Yours truly,



Paul Orlander
President, TD Mutual Funds
TD Asset Management Inc.