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Kivenko Comment Letter

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
https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20151210_81-102_mutual-fund-risk-classification-methodology.htm

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I have worked in close contact with a number of professional advisors for several years. These are advisors that work to a Best interests standard and have professional credentials like CFP/CFA. All have at least 10 years experience.

I reached out to them re the current consultation regarding mutual fund risk rating.

Virtually all of them provided me similar feedback. Kenmar are submitting a representative commentary on one individual's behalf (with his permission) because dealer representatives are discouraged / prohibited by their firms to make submissions directly to regulators.

Unfortunately ,regulators do not seek direct input either.

As a result , I am filing on their behalf .In doing so , I am giving them a voice.

Here is the Commentary from one individual that represents the consensus view :

In my meetings with investors and discussing Fund Facts with investors, I hesitate when I get to the risk classification section.100% of investors that I meet with assume the risk section means " the risk of losing one's capital." Even many advisors, still assume the risk section is equivalent to the prospectus definition of the fund's investment objectives where the fund manager generally describes the "riskiness" of the fund or perhaps generically suggests what type of investors the fund is appropriate for.

My understanding of the current Fund Facts risk scale is purely mathematically based using standard deviation which is a statistical measure of "ups" and "downs" of investment fund prices over a period of time. Standard deviation is really a measure of fluctuation and by definition is a measurement of the risk of a fund moving up in value (or down). Investors, generally are not primarily concerned with the risk of up markets or upward moving investment funds so the use of standard deviation as a measurement of risk may not be entirely appropriate. Conversely, although it sounds like a cliché these days, we all have heard of the <u>ideal low risk, low standard deviation investment fund that smoothly declines to zero.</u>

And that is one of the inherent flaws of using measurements of up/down fluctuations. For instance we have had several years of abnormally quiet stock markets and standard deviations(by their very nature) have come down in value. I do see a trend where even pure equity funds are starting to appear below the medium risk category. No fluctuation = no risk. Although these statistical measurements are empirically correct, they can lull investors and perhaps some advisors too, into a false sense of security where pure equity funds appear to be lower risk investments. As I approach three decades experience in this business, I can assure everyone that stocks, equities and equity mutual funds are not low risk investments.

We know from history that things can change very, very quickly. The low standard deviation which measures today as a low medium can be a high medium in short order. Some dealer's only have three categories; low, medium, high. A medium high classification does not exist at many dealers and would be forced automatically in to the "high" category triggering compliance off -sides where a client's stated medium risk category now has high risk funds. Compliance departments are required to tell advisors to get back onside. This puts advisors in the precarious position of molding a clients risk levels to the product which should never be done. Additionally, if the advisor is forced to sell the "high risk" investment which really might be one notch over"medium", there could be serious tax consequences to the investor to do so.

Although lengthening the measurement time to 10 years might help a little, I think we are missing the obvious here. When I have a discussion of risk with an investor regarding a pure equity fund, I speak in terms of maximum drawdown; i.e. Are you aware that the index dropped -57% between October 2007 and March 2009? and this medium-low fund only dropped -47%? during that same time frame. This where the rubber meets the road in determining risk tolerance.

Therefore, a classification of a "low-medium" Fund Facts classification will not properly convey the idea of "risk' when an investor is considering to purchase a mutual fund.

I would highly recommend that regulators use maximum drawdown numbers over longer periods to convey the true meaning of downside risk that investors can readily understand.

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.Yours truly,
 Ken Kivenko P.Eng. (on behalf of a advisor)