

## Annex B

### Proposed Amendments to National Instrument 81-102 *Investment Funds*

1. *National Instrument 81-102 Investment Funds is amended by this Instrument.*
2. *The Instrument is amended by adding the following Part:*

#### **PART 15.1 INVESTMENT RISK CLASSIFICATION METHODOLOGY**

**15.1.1 Use of Investment Risk Classification Methodology** – A mutual fund must:

- (a) determine its investment risk level, at least annually, in accordance with Appendix F– *Investment Risk Classification Methodology*; and
  - (b) disclose its investment risk level in the fund facts document in accordance with Part I, Item 4 of Form 81-101F3, or the ETF facts document in accordance with Part I, Item 4 of Form 41-101F4, as applicable..
3. *The Instrument is amended by adding the following Appendix F:*

#### **APPENDIX F– INVESTMENT RISK CLASSIFICATION METHODOLOGY**

##### *Commentary*

*This Appendix contains rules and accompanying commentary on those rules. Each member jurisdiction of the Canadian Securities Administrators (the CSA or we) has made these rules under authority granted to it under the securities legislation of its jurisdiction.*

*The commentary explains the implications of a rule, offer examples or indicate different ways to comply with a rule. It may expand on a particular subject without being exhaustive. The commentary is not legally binding, but it does reflect the views of the CSA. Commentary always appears in italics and is titled “Commentary.”*

##### **Item 1 Investment risk level**

- (1) Subject to subsection (2), to determine the “investment risk level” of a mutual fund,
  - (a) determine the mutual fund’s standard deviation in accordance with Item 2 and, as applicable, Item 3, 4 or 5,
  - (b) in the table below, locate the range of standard deviation within which the mutual fund’s standard deviation falls, and
  - (c) identify the investment risk level set opposite the applicable range.

<b>Standard Deviation Range</b>	<b>Investment Risk Level</b>
0 to less than 6	Low
6 to less than 11	Low to medium
11 to less than 16	Medium
16 to less than 20	Medium to High
20 or greater	High

- (2) Despite subsection (1), the investment risk level of a mutual fund may be increased if doing so is reasonable in the circumstances.
- (3) A mutual fund must keep and maintain records that document:
- (a) how the investment risk level of a mutual fund was determined, and
  - (b) if the investment risk level of a mutual fund was increased, why it was reasonable to do so in the circumstances.

*Commentary:*

- (1) *The investment risk level may be determined more frequently than annually. We would generally expect that the investment risk level be determined again whenever it is no longer reasonable in the circumstances.*
- (2) *We would generally consider a change to the mutual fund's investment risk level disclosed on the most recently filed fund facts document or ETF facts document, as applicable, to be a material change under securities legislation in accordance with Part 11 of National Instrument 81-106 Investment Fund Continuous Disclosure.*

## Item 2 Standard deviation

- (1) A mutual fund must calculate its standard deviation for the most recent 10 years as follows:

<i>Standard Deviation</i>	$\sqrt{12} \times \sqrt{\frac{1}{n-1} \sum_{i=1}^n (R_i - \bar{R})^2}$
<i>where</i>	$n = 120$ months $R_i =$ return on investment in month $i$ $\bar{R} =$ average monthly return on investment

- (2) For the purposes of subsection (1), a mutual fund must make the calculation with respect to the series or class of securities of the mutual fund that first became available to the public and calculate the “return on investment” for each month using:
- the net asset value of the mutual fund, assuming the reinvestment of all income and capital gain distributions in additional securities of the mutual fund;
  - the same currency in which the series or class is offered.

### *Commentary:*

*For the purposes of Item 2, except for seed capital, the date on which the series or class of securities “first became available to the public” generally corresponds to on or about the date on which the securities of the series or class were first issued to investors.*

## Item 3 Difference in classes or series of securities of a mutual fund

- (1) Despite Item 2(2), if a series or class of securities of the mutual fund has an attribute that results in a different investment risk level for the series or class than the investment risk level of the mutual fund, the “return on investment” for that series or class of securities must be used to calculate the standard deviation of that particular series or class of securities.

*Commentary:*

*Generally, all series or classes of securities of a mutual fund will have the same investment risk level as determined by Items 1 and 2. However, a particular series or class of securities of a mutual fund may have a different investment risk level than the other series or classes of securities of the same mutual fund if that series or class of securities has an attribute that differs from the other. For example, a series or class of securities that employs currency hedging or that is offered in the currency of the United States of America (if the mutual fund is otherwise offered in the currency of Canada) has an attribute that could result in a different investment risk level than that of the mutual fund.*

**Item 4 Mutual funds with less than 10 years of history**

- (1) For the purposes of Item 2, if it has been less than 10 years since securities of the mutual fund were first available to the public, the mutual fund must select a reference index that reasonably approximates the “return on investment” of the mutual fund.
- (2) When using a reference index, a mutual fund must:
  - (a) monitor the reasonableness of the reference index on an annual basis or more frequently if necessary,
  - (b) disclose in the mutual fund’s prospectus in Part B, Item 9.1 of Form 81-101F1 or Part B, Item 12.2 of Form 41-101F2, as applicable:
    - (i) a brief description of the reference index, and
    - (ii) if the reference index has changed since the last disclosure under this section, details of when and why the change was made.

*Instructions:*

- (1) *In selecting and monitoring the reasonableness of a reference index, a mutual fund should consider a number of factors including whether the reference index:*
  - (a) *is made up of one or a composite of several market indices that best reflect the returns and volatility of the mutual fund and the portfolio of the mutual fund;*
  - (b) *has returns highly correlated to the returns of the mutual fund;*
  - (c) *contains a high proportion of the securities represented in the mutual fund’s portfolio with similar portfolio allocations;*

- (d) has a historical systemic risk profile highly similar to the mutual fund;*
- (e) reflects the market sectors in which the mutual fund is investing;*
- (f) has security allocations that represent invested position sizes on a similar pro rata basis to the mutual fund's total assets;*
- (g) is denominated, in or converted into, the same currency as the mutual fund's reported net asset value;*
- (h) has its returns computed on the same basis (e.g., total return, net of withholding taxes, etc.) as the mutual fund's returns;*
- (i) is based on an index or indices that are each administered by an organization that is not affiliated with the mutual fund, its manager, portfolio manager or principal distributor, unless the index is widely recognized and used; and*
- (j) is based on an index or indices that have each been adjusted by its index provider to include the reinvestment of all income and capital gains distributions in additional securities of the mutual fund.*

#### **Item 5 Fundamental Changes**

- (1) For the purposes of Item 2, if there has been a reorganization or transfer of assets of the mutual fund pursuant to paragraphs 5.1(1)(f) or (g) or subparagraph 5.1(1)(h)(i) of the Instrument, the standard deviation must be calculated using the monthly “return on investment” of the continuing mutual fund, as the case may be.
- (2) Despite subsection (1), if there has been a change to the fundamental investment objectives of the mutual fund pursuant to paragraph 5.1(1)(c) of the Instrument, for the purposes of Item 2, the standard deviation must be calculated using the monthly “return on investment” of the mutual fund starting from the date of that change..
4. This Instrument comes into force on [●]. [Note: *90 days after final publication of this Instrument*].