

CANADIAN INVESTOR PROTECTION FUND

1997 ANNUAL REPORT TO INVESTORS

1969-1997

Message from the CHAIRMAN and the PRESIDENT

We are pleased to report that 1997 was another successful year of operation for CIPF and the self-regulatory system in Canada. The Fund balance increased by \$21 million during the year and now exceeds \$144 million. The healthy increase was the result of record industry revenues generating higher assessments and no insolvencies during the year (our last insolvency was in 1991).

What is CIPF?

CIPF was established in 1969 by an Agreement and Declaration of Trust. The present parties to the Trust are the Sponsoring Self-Regulatory Organizations (SSROs) — the Alberta, Toronto and Vancouver Stock Exchanges, The Montreal Exchange, The Toronto Futures Exchange and the Investment Dealers Association of Canada.

The primary role of CIPF is investor protection; that is, protection of customers, within defined limits, in the event of the insolvency of a Member. The secondary role of CIPF is oversight of the self-regulatory system. The secondary role provides a mechanism to help CIPF contain the risk associated with its primary role.

OUR INVESTOR PROTECTION ROLE

Protection Provided to Customers

CIPF covers customers' *losses* of securities and cash balances, within defined limits, that result from the *insolvency* of a Member. CIPF does not cover customers' losses that result from changing market values of their securities, regardless of the causes of such losses. The definition of security is very broad and it includes instruments such as stocks, mutual funds (including money market

Our Mission

To foster a healthy and active capital market in Canada by contributing to the security and confidence of investors who have accounts with Members of our Sponsoring Self-Regulatory Organizations.

CIPF protects investors, within defined limits, from loss of securities and cash balances that result from the insolvency of a Member.

CIPF and its Sponsoring Self-Regulatory Organizations establish national standards for financial responsibility and monitor Members' compliance with such standards in order to minimize exposure to loss.

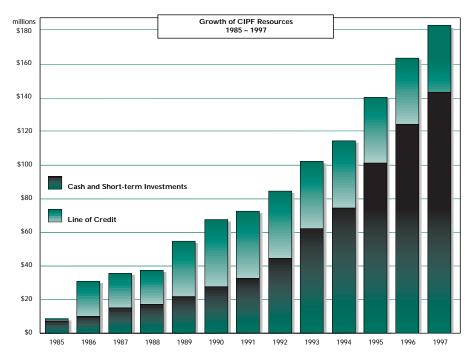
funds), options, futures, bonds, strip bonds, coupons, treasury bills and GICs.

Although the Governors have discretion concerning the validity of claims and payment of claims, their discretion is exercised according to policies they have adopted and which have been summarized in the CIPF brochure. At the present time the Governors have adopted policies which (i) define customers eligible for protection, (ii) establish limits of coverage, and (iii) define general and separate accounts. Members are required to provide their customers with the CIPF brochure and the Governors' detailed policy statements on request. Most customers will find

the material presented in the CIPF brochure adequate for their needs.

The Insolvency Process

In the event of the insolvency of a Member, CIPF would normally expect to petition the court under the Bankruptcy and Insolvency Act (BIA) to appoint a trustee to liquidate the firm and protect its customers. The trustee and CIPF will usually arrange to have customer accounts transferred in whole or in part to another CIPF Member. Customers whose accounts are transferred are notified promptly and permitted to deal with the new firm or subsequently transfer their accounts to firms of their own choosing. This procedure



minimizes disruption in customers' trading activities and access to their assets. In infrequent cases (for example, where an insolvent Member's records are inaccurate), account transfers may not be feasible. CIPF then protects customer accounts in the following manner:

- (a) Under the BIA, customers of an insolvent Member receive all securities registered in their names or in the process of being so registered and which are not, by endorsement or otherwise, in negotiable form. Payment of any indebtedness to the Member is required before the trustee will deliver customer name securities.
- (b) The trustee and CIPF will determine the net equity in the accounts of every customer at the date of the insolvency. The net equity in a customer's account is the total value of cash and securities (excluding customer name securities) owed to the customer by the insolvent Member, less the value of cash and securities owed by the customer to the insolvent Member. Thus, net equity represents the amount that would be owed to the customer if the account(s) were reduced to cash on the date of bankruptcy, taking into account any securities or cash brought into the accounts or payments made on indebtedness in the accounts after the bankruptcy. When a customer owes the Member more than the Member owes the customer, the customer must pay such amount to the trustee. Net equity is used in the pro rata distribution process described in (c).
- (c) Customers receive, on a pro rata basis, all cash, securities (other than securities registered in customer name noted in (a) above) and certain other assets held by the firm. Such assets constitute the customer pool fund described in the recent revisions to the BIA. After the pro rata distribution of the assets held in the customer pool fund by the trustee, CIPF's funds are available to satisfy any remaining claims of each customer up to the limits described below. All other assets not included in the customer pool fund comprise the general fund. Any assets remaining in the general fund after payment of liquidation expenses may be available to satisfy any remaining portion of customers' claims on a pro rata basis with general creditors.

General Account Coverage

A limit has been placed on the coverage provided by CIPF for the aggregate of losses in each customer's general accounts (that is, the total of losses in all cash, margin, short sale, options, futures and foreign currency accounts). The limit is \$500,000 for losses related to securities and cash balances in such accounts. The amount of coverage for the aggregate of cash balances in such general accounts, if any, included in the \$500,000 2 total coverage, may not exceed \$60,000.

Separate Account Coverage

CIPF provides separate coverage for certain types of account (or groups of similar accounts) disclosed in the records of a Member. Such accounts are treated as if they belonged to a separate customer and each such account is also entitled to the maximum coverage described for general accounts. Separate accounts include RRSPs, LIRAs, RRIFs, LIFs, RESPs, joint accounts and genuine trust accounts. Separate accounts are not combined with other separate accounts unless they are held by the customer in the same capacity or in the same circumstances.

It is important that investors recognize that a customer's loss is determined after the pro rata distribution by the trustee of all assets that comprise the customer pool fund. Customers will usually be given an opportunity to pay any amount they owe to the insolvent Member so that they may obtain all of the securities owing to them if they are available in the customer pool fund. Customers will not suffer a loss of net equity unless their share of any shortfall in the customer pool fund exceeds the limits of CIPF coverage. We believe that losses in excess of CIPF coverage limits will be very rare. The Securities Investor Protection Corporation (SIPC) in the United States has operated under similar legislation since the 1970s (the amendments to the BIA were modeled on the Securities Investor Protection Act). During its 27 years of operation, less than one-tenth of one percent of claims on SIPC have exceeded its limit and 80% of those claims occurred prior to the increase in its coverage limit to \$500,000 from \$100,000 in 1980. Prior to the adoption of the amendments to the BIA in Canada, there were no special provisions for the administration of the insolvency of a securities dealer. It was theoretically possible that the entire shortfall could be concentrated in the accounts of a small percentage of customers whose securities were not available, resulting in losses in excess of CIPF coverage for a few investors and no losses at all for the rest (fortunately, this never occurred). The amendments to the BIA (all customers now share pro rata in the assets that comprise the customer pool fund) have eliminated this risk to investors. As we noted in last year's Annual Report, CIPF and its advisors were actively involved in the development of this legislation for 29 years.

CIPF is funded by the securities industry through (i) regular quarterly assessments paid by Members based on their gross revenues, (ii) risk premiums based on capital deficiencies, and (iii) an annual refund by the SSROs of the interest allocated to them in the prior year. CIPF also maintains a \$40 million line of credit with a Canadian chartered bank.

Since 1984 total resources have grown by more than \$176 million to \$184.5 million at the end of 1997 (see chart), which represents more than seven times the total paid to customers (net of recoveries) since CIPF's inception in 1969. The

value of customers' securities held by Members now exceeds \$375 billion and defined losses over the past 29 years have been just \$25 million — all of which CIPF covered.

Investors should recognize that most of their securities are held by depositories (primarily the Canadian Depository for Securities) and book based mutual fund systems. The probability that such securities will not be available for inclusion in the customer pool fund if a Member becomes insolvent is very low. CIPF's total resources, together with the regulatory mechanisms described in this report, should provide investors with considerable comfort and confidence in the securities industry in Canada.

At March 31, 1998, the Fund balance reached \$153 million, providing CIPF with total resources of \$193 million.

World Wide Web

In 1995 we introduced our web site for investors (www.cipf.ca). The site includes the CIPF brochure, policy statements, advertising policy, annual reports (the current and prior years' reports are available in Acrobat pdf format for easy downloading), list of Members (updated monthly), answers to frequently asked questions and links to SSROs, Members, the Canadian Depository for Securities and SIPC. In 1998 the site will be updated frequently to provide investors with current information on the size of the Fund throughout the year. New links to securities commissions, CDIC, CompCorp and other organizations will also be added for the convenience of investors.

OUR OVERSIGHT ROLE

Agreement With The Canadian Securities Administrators (CSA)

The CSA is comprised of the authority (generally a securities commission) in each Canadian province and territory that, under statute, regulates the securities industry within its jurisdiction. Each of the Canadian Securities Administrators is responsible for promoting both investor protection and an active capital market in its jurisdiction. In order to carry out their responsibilities more efficiently, and to reduce possible duplicative and unnecessary regulatory burdens, CIPF and the CSA have formalized their relationship in an agreement made as of July 2, 1991.

The agreement with the CSA deals with the following matters:

- Organization of CIPF
- Funding and Maintenance of CIPF
- Customer Protection
- Financial and Operational Regulation
- Reporting to the CSA with Respect to Members

The Chairman and the President of CIPF meet with the CSA annually to report on CIPF activities including the matters outlined above.

CIPF Minimum Standards

CIPF and its SSROs, under the direct supervision of the CSA, establish and continuously review national standards for capital adequacy and liquidity, financial reporting, accounting records, internal control, segregation of customers' fully and partly paid securities, insurance and other matters relating to the financial condition of Members.

Examinations

The primary responsibility for financial examination of Members rests with the SSROs. The SSROs conduct at least one surprise field examination of each Member under their jurisdiction during the Member's fiscal year. Under the terms of the agreement with the CSA, CIPF conducts an annual review and evaluation of each SSRO's

examination activities to ensure that there is compliance with CIPF Minimum Standards. In addition, CIPF conducts financial examinations of Members on a rotational basis to ensure that they are in compliance with the Minimum Standards.

Robert B. Schultz Chairman

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President and Chief Executive Officer

BOARD OF GOVERNORS

December 31, 1997

PUBLIC GOVERNORS

Jean Béïque

· General Manager, CN Investments Division

Clayton Manness¹

- President, Man Agra Capital Inc.
- · Former Minister of Finance, Province of Manitoba

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- Professor of Law, Dalhousie University
- Former Vice-Chairman, Nova Scotia Securities Commission

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- Former Chairman, Canadian Pacific Ltd.

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- President, Sparrow Holdings Ltd.
- · Former Minister of Natural Resources, Government of Canada

Robert B. Schultz^{2,3}, CA

• Chairman, Midland Walwyn Capital Inc. (Industry Governor at large)

Donald A. Leslie^{2,3,4}, FCA, CFE

President

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- · Vice-President, ScotiaMcLeod Inc.

W. David Wilson²

- · Chairman, Investment Dealers Association of Canada
- · President, ScotiaMcLeod Inc.

René G. Jarry

- · Chairman, The Montreal Exchange
- Senior Executive Vice-President, Lévesque Beaubien Geoffrion Inc.

Barbara G. Stymiest^{2,3,4}, FCA

- Chairman, The Toronto Stock Exchange
- · Senior Vice-President, Nesbitt Burns Inc.

J. Chris Lay1,4

- Vice-Chairman, Vancouver Stock Exchange
- Vice-President, CIBC Wood Gundy Securities Inc.

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· President, The Alberta Stock Exchange

Joseph J. Oliver4

• President, Investment Dealers Association of Canada

Gérald A. Lacoste⁴, o.c.

· President, The Montreal Exchange

Rowland W. Fleming

· President, The Toronto Stock Exchange

Michael E. Johnson

• President, Vancouver Stock Exchange

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- Vice-President, Midland Walwyn Capital Inc.

Kenneth A. Shields3

- · Vice-Chairman, Investment Dealers Association of Canada
- · President, Goepel Shields & Partners Inc.

Luc Bertrand

- Vice-Chairman, The Montreal Exchange
- · Executive Vice-President, Deacon Capital Corporation

Daniel F. Sullivan

- Vice-Chairman, The Toronto Stock Exchange
- · Deputy Chairman, ScotiaMcLeod Inc.

Gordon M. Medland

- Honorary Secretary-Treasurer, Vancouver Stock Exchange
- · Vice-President, McDermid St. Lawrence Securities Ltd.

OFFICERS

Robert B. Schultz, ca

• Chairman

COUNSEL

Donald A. Leslie, FCA, CFE

· President & Chief Executive Officer

Rozanne E. Reszel, ca. CFA

Vice-President & Secretary

Michael J. Tims

- Vice-Chairman
- · President, Peters & Co. Limited

AUDITORS

Ernst & Young

Borden & Elliot

- ¹ Member of the Audit Committee
- ² Member of the Investment Committee
- ³ Member of the Budget and Finance Committee ⁴ Member of the Governance Committee

SUMMARIZED BALANCE SHEETS			
As at December 31			
	19	97	1996
ASSETS			
Cash	\$ 7,6	20 \$	78,343
Short-term investments (at market value)	145,203,5	75	126,504,363
Fourth quarter Member assessments received in February 1998 (1997)	4,255,4	85	3,957,188
	\$ 149,466,6	80 \$	130,539,894
LIABILITIES AND FUND BALANCE			
Liabilities			
Accounts payable and accrued charges	\$ 295,5	39 \$	341,327
Balance of net income allocated to SSROs	4,616,0	18	6,664,811
Total liabilities	\$ 4,911,5	57 \$	7,006,138
Fund balance	\$ 144,555,1	23 \$	123,533,756
	\$ 149,466,6	80 \$	130,539,894
FUND RESOURCES			
Fund balance	\$ 144,555,1	23 \$	123,533,756
Bank line of credit	\$ 40,000,0	00 \$	40,000,000
Total Fund resources	\$ 184,555,1	23 \$	163,533,756
SUMMARIZED STATEMENTS OF INTEREST EARNED AND FUND ACTIVITIES			
Years ended December 31			
	19	97	1996
INTEREST EARNED			
Interest earned on short-term investments representing			
net income allocated to SSROs	\$ 4,616,0	18 \$	6,664,811
FUND ACTIVITIES			
Fund balance, beginning of year	\$ 123,533,7	56 \$	100,522,540
Add:			
Regular assessments	16,043,5	08	14,239,411
Risk premiums	30,7	25	44,981
Contributions by SSROs of prior years' interest earned	6,664,8	11	6,602,103

AUDITORS' REPORT

Operating expenses

Fund balance, end of year

Deduct:

To the Board of Governors of the Canadian Investor Protection Fund

Recovery of funds re prior year insolvencies

We have audited, in accordance with generally accepted auditing standards, the financial statements of the **Canadian Investor Protection Fund** for the years ended December 31, 1997 and 1996 and have reported thereon without reservation to the Board of Governors on February 27, 1998. Our audits included the above summarized balance sheets and summarized statements of interest earned and Fund activities.

In our opinion, the above summarized balance sheets and summarized statements of interest earned and Fund activities fairly summarize the related information contained in the full financial statements which we audited.

Toronto, Canada February 27, 1998 **Ernst & Young**Chartered Accountants

(1,717,677)

\$ 144,555,123

3,814,942

(1,690,221)

\$ 123,533,756