

## Chapter 13

# SRO Notices and Disciplinary Proceedings

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### 13.1.1 MFDA IPC Notice and Request for Comment - Revised Application for Approval of MFDA Investor Protection Corporation/Corporation de Protection des investisseurs de l'ACFM, Pursuant to Section 110 of Reg. 1015 Made Under the Securities Act

#### NOTICE AND REQUEST FOR COMMENT – REVISED APPLICATION FOR APPROVAL OF MFDA INVESTOR PROTECTION CORPORATION/CORPORATION DE PROTECTION DES INVESTISSEURS DE L'ACFM, PURSUANT TO SECTION 110 OF REGULATION 1015 MADE UNDER THE SECURITIES ACT

##### A. Revised Application

The Commission is publishing for comment the revised application (Revised Application) of the Mutual Fund Dealers Association of Canada (MFDA) and the MFDA Investor Protection Corporation/Corporation de Protection des investisseurs de l'ACFM (MFDA IPC) for the approval by the Ontario Securities Commission (Commission) of the MFDA IPC as a compensation fund, pursuant to subsection 110(1) of R.R.O. 1990, Regulation 1015, as amended (Regulation), made under the Securities Act R.S.O. 1990, c. S.5, as amended (Act). The Commission is also publishing for comment the proposed form of approval order (Proposed Approval Order).

In a decision (Recognition Order) dated February 16, 2001, the Commission recognized the MFDA as a self-regulatory organization for mutual fund dealers, pursuant to section 21.1 of the Act, subject to certain terms and conditions.<sup>1</sup> The Recognition Order contemplated that a compensation fund would be established for customers of members of the MFDA, which the Recognition Order described as the "Mutual Fund Dealers Investor Protection Plan". The Recognition Order stated that the Commission intended to publish for comment the plan, once received, and would consider it once it had reviewed any comments received. It also stated that members of the MFDA would continue to participate in the Ontario Contingency Trust Fund as required under section 110 of the Regulation until another compensation fund or contingency trust fund authorized by the Commission commenced its coverage.

The MFDA and the MFDA IPC submitted an application, dated November 14, 2002, (Initial Application) to the Commission seeking Commission approval of the MFDA IPC as a compensation fund for customers of members of the MFDA. The Initial Application was published for public comment in the Ontario Securities Commission Bulletin on November 29, 2002, at (2002) 25 OSCB 8095. Eight comment letters were received. The MFDA and MFDA IPC's summary of comments and responses is also being published at this time. As a result of making revisions to the Initial Application, the MFDA and MFDA IPC have now submitted the Revised Application.

Submitted with the Revised Application are the following supporting documents, which are also being published:

1. MFDA IPC Letters Patent Pursuant to Part II of the *Canada Corporations Act* (Exhibit A);
2. By-law No. 1 of the MFDA IPC (Exhibit B);
3. Draft policy relating to MFDA IPC customer coverage (Exhibit C);
4. Proposed amended MFDA advertising rule with commentary regarding the proposed amendments (Exhibit D);
5. Proposed MFDA advertising policy relating to MFDA IPC (Exhibit E).

Exhibits B through E have been revised from the versions published with the Initial Application. Marked copies, showing the revisions made to the Exhibits published on November 29, 2002, can be found on the OSC website.

We are seeking comments on all aspects of the Revised Application and related documents.

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<sup>1</sup> (2001) 24 O.S.C.B. (Supp) 7.

**Proposed Amended MFDA Rule and Proposed MFDA Policy Relating to Advertising and Comments on the Amended Rule and Proposed Policy**

In connection with the Revised Application, the MFDA proposes to amend MFDA Rule 2.7 – Advertising and Sales Communications and to create related MFDA Policy Number 4. Exhibit D to the Application contains a MFDA notice that requests comments on the Amended Rule and the related Proposed Policy (Exhibit E).

**B. Proposed Approval Order**

The Proposed Approval Order establishes terms and conditions in the following areas:

1. Corporate Structure and Purpose of MFDA IPC
2. Corporate Governance
3. Funding and Maintenance of MFDA IPC
4. Customer Protection
5. Financial and Operational Viability
6. Risk Management
7. Reporting to the Commission
8. Rules
9. Agreement between the MFDA IPC and the MFDA
10. Establishment of a Working Group

**C. Comment Process**

Please deliver your comments on the Revised Application in writing before March 28, 2005, addressed to the attention of the Secretary of the Commission, Ontario Securities Commission, 20 Queen Street West, Toronto, Ontario M5H 3S8.

We request that you submit a diskette containing an electronic copy of your comments. The confidentiality of submissions cannot be maintained as a summary of written comments received during the comment period will be published.

Questions may be referred to:

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**MUTUAL FUND DEALERS ASSOCIATION OF CANADA  
AND  
MFDA INVESTOR PROTECTION CORPORATION  
Suite 1600  
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M5H 3T9**

November 15, 2004 (revised)

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Alberta Securities Commission  
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Nova Scotia Securities Commission  
Joseph Howe Building  
P.O. Box 458, 2<sup>nd</sup> Floor  
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Halifax, Nova Scotia B3J 3J9

Dear Sirs/Mesdames:

**Re: Mutual Fund Dealers Association of Canada and  
MFDA Investor Protection Corporation**

This letter sets out the revised application of the Mutual Fund Dealers Association of Canada ("MFDA") and the MFDA Investor Protection Corporation\Corporation de protection des investisseurs de l'ACFM (the "IPC" or "MFDA IPC") to the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Securities Commission, the Manitoba Securities Commission, the Ontario Securities Commission and the Nova Scotia Securities Commission (collectively the "Commissions") for approval, designation or consideration, as the case may be, of the IPC as a protection plan for customers of mutual fund dealers which are members of the MFDA pursuant to the applicable securities legislation (the "Legislation"). Reference is made to (i) Section 110 of the regulation under the *Securities Act* (Ontario), Section 23 of the Rules made under the *Securities Act* (British Columbia) and Section 27 of the Regulation under the *Securities Act* (Nova Scotia), and (ii) to the respective recognition orders relating to the MFDA referred to herein. Included with the application for such approval in connection with IPC is the application of MFDA for approval of certain new and amended Rules and policies of the MFDA pursuant to such recognition orders relating to MFDA.

**Revised Application and CIPF**

This letter revises and replaces the application of the MFDA and MFDA IPC to the Commissions dated November 14, 2002 (the "Initial Application"). The Initial Application was based on an application filed with the Commissions in August 2001 which was not published but which was the basis for discussions between MFDA IPC and the Commissions. The Initial Application was published for public comment including in the Ontario Securities Commission Bulletin, Issue 25/48 on November 29, 2002. The public comment period expired in January 2003 and a number of comments were received. Most commentators questioned whether an investor protection fund for MFDA members was necessary at all in view of the facts that the risks were relatively low and a high percentage of client assets were held in client versus nominee name, i.e. the customer's claim for property was

directly against the mutual fund manager and not the dealer. The Commissions have confirmed that having no fund at all would not be acceptable. On that basis, commentators on the MFDA IPC proposal questioned whether the coverage available should be similar to that provided by Canadian Investor Protection Fund ("CIPF") and, consequentially, whether there should be two separate investor protection funds or whether MFDA members could participate in CIPF.

The Board of the MFDA considered the responses to the publication of the proposal for MFDA IPC and concluded, subject to certain conditions, that the prospect of MFDA participating in CIPF should be pursued. Accordingly, in the spring of 2004, discussions were commenced with the board and management of CIPF. The MFDA was (and continues to be) of the view that the businesses of mutual fund dealers are different in significant respects from those of investment dealers and, accordingly, the insolvency risks are different. As a result of the initial discussions, a formal working group consisting of representatives of both CIPF and MFDA was established to study the differences between the MFDA Rules and CIPF Minimum Standards as well as the general differences in the operations and risks of both mutual fund dealers and investment dealers. The significant differences included capital requirements, client reporting, the assessment base, distribution structures and client versus nominee holdings.

At the conclusion of the review process described, it was apparent that many of the differences identified between the businesses and risks of MFDA members and investment dealers could be resolved. However, there remained some matters that required further consideration and the view of CIPF was that a transition period would be required before MFDA members could fully participate in CIPF. This transition period would provide time for amending the rules of both organizations as well as to permit the organizations to gain experience with the risks relevant to the businesses of MFDA members.

The Board of Directors of MFDA has carefully considered the circumstances described above and has decided to proceed with the establishment of MFDA IPC as soon as possible. However, the proposal is that the customer loss coverage to be offered by MFDA IPC would be similar in substance to that of CIPF, namely that all financial products held by an MFDA member would be eligible for coverage and that the amount of coverage per separate account (as defined in the coverage policies) would be \$1 million. In order to provide such coverage, the MFDA Board is satisfied that an initial fund containing liquid financial assets of at least \$30 million would be adequate.

Based on the foregoing conclusions of the MFDA Board, it was determined that the application of MFDA IPC to the relevant members of the CSA would be amended and resubmitted for approval. In addition, MFDA and MFDA IPC expect that within a reasonable period of time MFDA members would participate in CIPF on terms that are appropriate for MFDA members and the public interest. The intent is that customers acquiring financial products from Canadian investment dealers and mutual fund dealers could look to one customer protection fund, i.e. CIPF. In order to achieve this objective, MFDA and MFDA IPC will continue to review what changes to both MFDA and CIPF requirements may be necessary and appropriate to permit MFDA to participate in CIPF. CIPF has indicated that it looks forward to an opportunity to welcome MFDA as a sponsoring SRO of CIPF.

### **Approval Criteria**

The MFDA has been recognized as a self-regulatory organization by order of certain of the Commissions under the Legislation and such orders contemplate that a compensation or contingency trust fund will be established for customers of members of the MFDA. IPC is to be established for this purpose and is applying for approval as a protection plan. The Commissions have identified seven proposed criteria ("Criteria") to be satisfied by IPC in this regard and draft terms and conditions ("Terms and Conditions") to any order so approving the IPC. For convenience this application is divided into the following sections and sections 2 to 8, inclusive, set out the proposed Criteria together with a description of how IPC satisfies the Criteria as well as the draft Terms and Conditions:

1. Background
2. Corporate Structure and Purpose of IPC
3. Corporate Governance
4. Funding and Maintenance of IPC
5. Client Protection
6. Financial and Operational Viability (Including Risk Management)
7. Reporting to Securities Commissions
8. Rule Making
9. Submissions

Submitted with this application are the following supporting documents:

1. the Letters Patent of IPC issued pursuant to Part II of the *Canada Corporations Act* (Exhibit A);
2. draft By-law No. 1 of the IPC (Exhibit B);
3. draft policy relating to IPC customer coverage (Exhibit C);
4. proposed MFDA advertising Rule with commentary regarding the proposed amendments (Exhibit D);
5. proposed MFDA advertising policy relating to IPC coverage (Exhibit E).

The documents referred to in items 2, 3, 4 and 5 above have been revised from the versions submitted with the Initial Application.

## **1. BACKGROUND**

The establishment of the MFDA was the result of certain industry studies and commentary that were spurred by the explosive growth and popularity of mutual funds in the late 1980s and throughout the 1990s. The concerns of some of the Commissions which were members of the Canadian Securities Administrators (the "CSA") in promoting the establishment of the MFDA included concerns relating to investor protection for mutual fund investors. Some of these concerns were articulated in the report by Ontario Securities Commissioner, Glorianne Stromberg, entitled: "Regulatory Strategies for the Mid-1990's: Recommendations for Regulating Investment Funds in Canada" (the "Stromberg Report"), published in 1995 and that Report, as well as initiatives of the CSA, assumed that an investor protection plan similar to CIPF would be established or that CIPF would provide the coverage. CIPF provides investor protection to eligible customers of insolvent securities dealers who are members of self-regulatory organizations such as the IDA and the Canadian exchanges.

The Stromberg Report referred to the fact that certain Provinces of Canada (British Columbia, Ontario, Quebec and Nova Scotia) had established protection plans for customers of registrants in those provinces but that the coverage available was limited to amounts of \$2,500 to \$25,000 depending upon the province. Further, these plans did not provide the amount of protection that reasonably represents the financial risk that consumers of mutual fund securities doing business with mutual fund dealers may be exposed to.

As part of the early development of the MFDA, a number of industry committees were established to accumulate mutual fund industry experience and make recommendations on a number of subjects including an investor protection plan and matters relating to prudential regulation of members. The Board of Directors of the MFDA and its staff reviewed the reports and recommendations of the industry committees referred to above and assessed them in the context of available resources and what were perceived to be the regulatory objectives. A preliminary review of the role and functions of IPC according to the MFDA Board was published for comment in its recognition application to the Commissions. The purpose and operations of IPC have been refined as a result of the work of the committees, the MFDA Board, the first IPC directors, comments by the public and MFDA members in respect of the Initial Application and consultations with the Commissions. This revised application is submitted on the authority of the Board of Directors of both the MFDA and the IPC.

## **2. CORPORATE STRUCTURE AND PURPOSE OF THE IPC**

### **CSA Criteria**

**The MFDA IPC has the appropriate legal authority to carry out its objective of providing protection to clients of the members of the MFDA if the client property held by such members becomes unavailable as a result of the insolvency of such members, in accordance with established rules, regulations or policies of the MFDA IPC.**

### **2.1 Corporation**

The IPC has been established as a non-share capital corporation under Part II of the *Canada Corporations Act* (the "CCA"). This form of organization was based on an assessment of several considerations including a review of the structure of other financial services investor protection plans such as the Canadian Investor Protection Fund ("CIPF"), Canadian Deposit Insurance Corporation ("CDIC"), The Canadian Life and Health Insurance Compensation Corporation ("Compcorp") and The Property and Casualty Insurance Compensation Corporation ("PACICC"). The MFDA is itself a corporation established under Part II of the CCA.

The implications of adopting a not-for-profit corporation structure relate to the governance of the IPC, requirements to comply with certain statutory requirements, financial and income tax considerations and legal responsibilities. The MFDA and the IPC are of the view that the functions and role of the IPC can be best accommodated with the proposed corporate form.

## 2.2 Letters Patent

A non-share capital corporation under Part II of the CCA is created by a grant of letters patent by the federal government (Crown) on application to Industry Canada. The letters patent describe the objects of the IPC, its first directors and other basic characteristics. A copy of the letters patent of IPC is filed with this application as Exhibit A.

## 2.3 By-Laws

The main procedural documentation by which the affairs of the IPC will be governed are its by-laws. For the most part, the by-laws govern the procedures by which the IPC will conduct its activities including provisions for meetings of directors and members, the appointment of officers, indemnities and insurance, and other administrative matters. The by-laws of the IPC as a Part II CCA corporation, and certain amendments, must be approved by Industry Canada before becoming effective. A copy of the by-laws of IPC, included in draft in the Initial Application, is filed with this application as Exhibit B. Certain amendments to the by-laws of IPC are anticipated by this application. These by-laws are binding on the directors and members of IPC but not directly on members of the MFDA. However, by agreement between MFDA and IPC and the effect of MFDA's by-laws which bind its members, those members are bound to the extent necessary including the obligation to pay assessments: see MFDA By-law 15.1.3.

## 2.4 Income Tax Status

The IPC, as a non-share capital corporation under Part II of the CCA, is structured so that it will qualify as being exempt from income tax under the *Income Tax Act* (Canada) and corresponding provincial income tax legislation. This status will require that the IPC operate exclusively on a not-for-profit basis and that no part of its net income be payable to or available for the benefit of any members.

## 2.5 Purpose of the IPC

The primary purpose of the IPC is to provide protection to eligible clients of the MFDA members if client property held by such members is unavailable as a result of the insolvency of the member. The role of the IPC in providing customer protection to clients of MFDA members is in the public interest. This parallels the MFDA's own public interest mandate. In recognition of the IPC's responsibilities to the public, the IPC and its operations have been structured to ensure that it will be responsive to the concerns and needs of the investing public. The proposal described for MFDA and IPC to pursue the possibility of MFDA members participating in CIPF is consistent with IPC's role. IPC is not an insurer and IPC coverage is not insurance and, accordingly, provincial insurance regulations do not apply to IPC or its coverage.

## 2.6 MFDA Member Insolvency

In the event of insolvency of a member of the MFDA, the IPC shall respond quickly and decisively, in accordance with its established rules, regulations or policies for assessing claims. The IPC shall also co-operate and provide reasonable assistance to the MFDA, a trustee in bankruptcy or securities regulators in administering an insolvency.

## 3. CORPORATE GOVERNANCE

### CSA Criteria

- (a) **The arrangements with respect to the appointment, removal from office and functions of the persons ultimately responsible for making or enforcing the rules of the MFDA IPC, namely, the governing body, are such as to ensure a proper balance between the differing interests of the MFDA members participating in the MFDA IPC, and in recognition that the protection of the public interest is a primary goal of the MFDA IPC, a reasonable number and proportion of directors are independent of the MFDA and its members in order to ensure diversity of representation on the Board of Directors.**
- (b) **Without limiting the generality of the foregoing, the MFDA IPC should provide for:**
  - (i) **fair and meaningful representation on its governing body, in the context of the nature and structure of the MFDA IPC, and any governance committee thereto, including the audit committee, and in the approval of rules, regulations and policies;**
  - (ii) **appropriate representation of persons independent of the MFDA or any of its members or of any affiliated or associated company of such member on any executive committee or similar body; and**

- (iii) **appropriate qualification, remuneration, conflict of interest provisions and limitation of liability and indemnification protections for directors and officers and employees of the MFDA IPC generally.**

### **3.1 General**

The manner in which the affairs of IPC are governed is critical to its ability to achieve its objectives and fulfil the purposes and functions expected of it. There are a number of interests that are to be reflected in the activities of IPC and which will require, to a greater or lesser degree, some participation in the governance of IPC. These interests include the members of the MFDA, customers of such members, the MFDA itself, the CSA and the public at large.

### **3.2 Members**

As a non-share capital corporation under the CCA the IPC has members rather than shareholders. The members of the IPC are to be the same persons who are the directors. This is for ease of administration as it is impractical for a broader membership to be appointed. Accordingly, there will be one class of members, all of whom will be voting members. The primary role of members is to appoint the auditor of the corporation and confirm by-laws. The members must meet at least annually although there are provisions for members to act by instrument in writing if all or a specified majority of members sign a resolution affecting any particular business.

### **3.3 Board of Directors**

The constating documents of the IPC provide that its Board will have a maximum size of 11 directors and a minimum size of 3 directors. The Board of the IPC shall be composed of an odd number of directors, the minority of which would be nominees of the MFDA (industry directors) and the majority would be public directors elected by the Board. Since the IPC is intended to protect customers of the members of the MFDA, the most appropriate representatives of the industry are representatives of the members or the MFDA. Although the initial by-laws provide that industry directors cannot be removed from office without the consent of the MFDA, this provision is to be deleted. In addition, the initial by-laws will be amended to provide that all industry directors shall be nominated by MFDA, but the election or appointment of such nominees as directors will be by the IPC Board or members. The definition of "Industry Directors" and "Public Directors" is set out in By-law 4.1 of the IPC constating documents (Exhibit B-2). By-law 4.2 sets out the details of the qualifications of the directors (both public and industry) including geographical considerations and the criteria established by the Board in appointing or nominating the directors. The initial by-laws are also being amended to conform (in general terms) the definition of Public Directors with the corresponding term in the by-laws of MFDA.

By-law 4.7 lists a series of events giving rise to the automatic termination of office of a director. A retiring director shall remain in office until the dissolution or adjournment of the meeting at which such retirement is accepted and a successor is elected.

In addition, there will be a Chair who will be appointed by the directors from one of their number and who could be either an industry director or a public director. This approach reflects the IPC view that the Chair should be the best person for the position, and is consistent with good industry and corporate governance. This structure would be reflected in whatever size the Board may be, provided that a majority of the Board is always independent or public directors. The term of office for all directors will be limited to two three-year terms which will be staggered to ensure appropriate continuity and experience. The current directors of the IPC are Mr. Lawrence A. Wright (public and Chair), Mr. Donald H. Page (public) and Mr. W. David Wood (industry). Public directors will be recommended by a nominating committee of the Board composed of an equal number of MFDA appointees and public directors (four in total when the size of the board permits). The Board of the IPC will appoint the public directors.

The President may be the chief executive officer or chief operating officer of the IPC. The rights and duties of the president are outlined in By-law 11.2 of the attached constating documents.

### **3.4 Conflicts of Interest**

By-law 5.1 establishes procedures in dealing with conflicts of interest of the directors and disclosure requirements.

### **3.5 Liability and Indemnity of Directors**

The By-laws of the IPC stipulate that any director or officer will not be held liable for any act, receipt, neglect or default of any other director, officer or employee for any loss described in Section 6.1 of the By-laws, while acting as a director or officer for the IPC. Indemnities by IPC to directors and others are provided for in Section 7.1. In addition, IPC is authorized to purchase insurance in respect of acts and omissions of its directors and officers and intends to do so prior to IPC protection being available. Sections 6 and 7 of the By-laws are to be amended to conform to the corresponding provisions of the MFDA by-laws.

### 3.6 Remuneration of Directors

Directors of the IPC will receive remuneration in a manner similar to comparable organizations.

### 3.7 MFDA

The MFDA has proposed that the IPC be a separate organization with separate assets and governance. However, there will be close interaction between the MFDA and the IPC and the terms of this relationship will be defined in the by-laws and by way of operating agreements. Of immediate concern during the initial phase of the IPC is the need for funding of the IPC's start-up costs through the MFDA and to date MFDA has advanced funds to IPC which are to be repaid by IPC. The IPC and the MFDA are in the course of determining the appropriate terms of this relationship. The interests of the MFDA dealer members will be represented through the MFDA's participation in IPC governance.

### 3.8 CSA

In certain provincial jurisdictions of members of the CSA, it is a requirement of registration as a securities or mutual fund dealer that it be a member of an investor protection plan that has been approved by the applicable securities commission, executive director or delegated authority. The IPC is applying for approval in such jurisdictions for that purpose. The securities commissions in some or all of these jurisdictions will have regulatory oversight over the activities of the IPC.

### 3.9 Customers (Public)

The primary beneficiaries of the IPC are the customers of insolvent members of the MFDA. Customers, as the investing public, will primarily be represented by the public directors on the Board of Directors of the IPC as well as the oversight of members of the CSA. In addition, the IPC will be expected to be responsive to public comment and enquiries.

### 3.10 Audit Committee

The IPC will create an audit committee as a committee of the Board. The IPC Board will be responsible for selecting the audit committee members. The audit committee will be composed of three or more directors, the majority of which will be public directors. The audit committee shall be responsible for the review of the Corporation's annual financial statements and such other functions as the Board shall determine by resolution. The IPC will be required to appoint an auditor to prepare a report on the annual financial statements. The role and performance of the auditor will be monitored by the audit committee.

### 3.11 Other Committees

The Board may also appoint an executive committee and shall appoint a nominating committee and any other committee subject to By-law ss. 8.2, 8.4 and 8.5. The executive committee, if appointed, requires an equal number of industry and public directors. The initial By-law Section 8.4 provides that the nominating committee is to be composed of two public and two industry directors; this Section will be amended prior to commencement of IPC coverage to refer to an even number of industry and public directors. However, the Board which appoints the other committees (and is always comprised of more public than industry directors) can be expected to ensure that appropriate balance in representation is maintained. When, or if, the Board increases in size, consideration may be given to fixing other committee composition in the by-laws.

## 4. FUNDING AND MAINTENANCE OF IPC

### CSA Criteria

- (a) **Any and all assessments imposed by the MFDA IPC on the MFDA members to finance the MFDA IPC are equitably allocated. Assessments do not have the effect of creating barriers to becoming members of the MFDA. The assessments must also be balanced with the criteria that the MFDA IPC has sufficient revenues to satisfy claims in the event of insolvency of an MFDA member and has sufficient financial resources to satisfy its operational costs.**
- (b) **The MFDA IPC's process for setting assessments is a fair and reasonable method of establishing equitable assessments for each MFDA member's contribution, including, among other things, rules, regulations or policies that govern the contributions of affiliates and subsidiaries of MFDA members.**
- (c) **The MFDA IPC provides the Commission with a current copy of the method of assessments and notifies the Commission 30 days prior to making any changes to the method of assessing MFDA members.**



- (d) **The Board determines the appropriate level of assets for the MFDA IPC and ensures that the level of assets of the MFDA IPC is adequate. Any material adverse change in the level of MFDA IPC assets, or upon becoming aware of the potential for any material adverse change, is immediately reported to the Commission by the MFDA IPC.**
- (e) **The MFDA IPC implements an appropriate accounting system, including a system of internal controls for maintaining the MFDA IPC. The MFDA IPC appoints an independent auditor for the purpose of conducting an audit of the MFDA IPC's annual financial statements in accordance with generally accepted auditing standards.**
- (f) **Moneys in the MFDA IPC are invested in accordance with rules, regulations and policies approved by the Board. These rules, regulations and policies shall be provided to the Commission and the MFDA IPC shall also inform the Commission of any changes in these rules, regulations or policies.**

#### **4.1 Fund Size**

The MFDA and IPC have agreed that an initial fund size of not less than \$30 million is appropriate to permit IPC commence operations and to provide coverage of up to \$1 million per separate account for eligible claims (with no deductible). The actual and target size of the fund will be reviewed by the IPC Board periodically and appropriate changes to fund size will be recommended. The funding and assessment proposals by way of member assessment and borrowings are described in the following section. Any change proposed by IPC in the target size of the IPC's assets shall be made only after consultation with MFDA. If IPC and MFDA are unable to agree on the proposed change, the disagreement will be immediately reported to the appropriate members of the CSA. Additional amounts may be required each year depending on losses paid or the IPC's operating expenses to the extent that income from the fund size is not sufficient to cover such expenses (including start-up costs). The first year of coverage would commence in April, 2005 or as soon thereafter as regulatory approvals permit. The size and appropriate level of assets in the IPC is a function of several considerations including the predicted risk of loss, the amount of coverage to be provided and the financial ability of members to immediately fund the IPC. IPC, MFDA and the various sources they have consulted have not been able to determine any accurate or experience-based formula for initial fund size. The proposed initial size of \$30 million appears to be reasonable in view of the proposed coverage of \$1 million per customer and the member assessments required.

Where the size of the fund becomes less than its target size at any time or the eligible claims on the fund exceed the IPC's immediately available assets, the IPC will be able to make assessments to replenish the fund to its target size or to satisfy such claims and MFDA will undertake to assess its members accordingly. The MFDA and the IPC will cooperate in seeking funds by assessment, third party borrowings or other appropriate sources.

Any material adverse change in the level of the IPC's assets would be reported immediately to both the MFDA and members of the CSA. In addition, the summarized annual audited financial statements of the IPC will be available to the public and full audited statements will be provided to the MFDA and members of the CSA.

#### **4.2 General Funding**

The overriding principle of the IPC's funding is that the MFDA members collectively are to be responsible for the payments of client losses arising as a result of the insolvency of an MFDA member. The IPC has considered various sources of funding for IPC (member assessments, third party financing, use of interest accumulated in member trust accounts, integration with other industry protection plans, the current provincial protection plans and other risk funding mechanisms) and has concluded that the MFDA member assessments should be the long-term method of funding the IPC. This approach is consistent with similar insolvency protection plans such as CIPF, CDIC, Securities Investor Protection Corporation ("SIPC") and the Deposit Insurance Corporation of Ontario ("DICO") and plans approved by certain CSA members for securities and mutual fund dealers.

The short term method of funding the IPC for start-up costs has been by advances from the MFDA which will be required to be repaid. Thereafter funding will be by way of (i) assessments of MFDA members which are required to contribute to the IPC the amounts assessed; (ii) the establishment of a line of credit (or similar facility) with one or more institutional lenders in an aggregate amount of not less than \$25 million; and (iii) contributions of assets by MFDA or other persons. On the commencement of coverage (planned for April 1, 2005) IPC will have cash assets of not less than \$2.5 million (from (i) and (iii)) and the line of credit referred to in (ii). Contributions by MFDA members through assessments become the property of the IPC and members will no longer have any proprietary interest in the contributions. If the IPC is terminated, the property held by the IPC after payment of its obligations would be distributed to an organization with like objects in connection with Canadian capital markets and the public interest.

#### **4.3 Assessments**

The IPC may impose or prescribe fees, levies, assessments or other charges on or in respect of persons who are members of the MFDA. The IPC may make arrangements for the notification and collection of the fees, levies or assessments either directly or indirectly through the MFDA. The amount, nature and basis of any fee, levy or assessment is determined by the Board in its sole discretion subject to consultation with MFDA as described. The liability for such fees, levies and assessments is that of the members and not the MFDA itself.

The initial assessment methodology to be adopted by the IPC including the annual assessment amount, maximum permitted annual assessments and any special or penalty assessments has been agreed to by the MFDA and is described below. MFDA member assessments are to be the long-term method of funding the IPC. The initial basis for assessments is to be based on assets under administration (AUA) as determined for MFDA fee purposes. The best judgment of the boards of both the MFDA and the IPC is that the AUA model is an appropriate proxy for the risks to be covered by the IPC. An assessment at the annual rate of \$22-24 per million of AUA (depending on the then current industry AUA) is scheduled to be made in 2005 (subject to approval of IPC by the relevant Commissions) which would be payable by members in quarterly instalments in June, September and December, 2005 if coverage were to commence April 1, 2005. Thereafter, annual assessments of \$22-24 per million of AUA will be made for a period of five years. This annual assessment will be made and be payable quarterly in equal instalments to coincide with the payment of MFDA membership fees. The Board of IPC will review annually the foregoing basis of assessments to determine that it is appropriate in accordance with a variety of relevant factors such as fund size targets, economic and mutual fund industry conditions, interest rates and fund loss experience.

The foregoing assessment schedule and amounts are subject to change if MFDA members participate in CIPF as discussed above. In this regard, it is noted that corresponding assessments of members of CIPF are based on gross revenues of members.

The mechanism for determining and collecting MFDA members' assessments will be refined but the working premise is that the IPC Board will review the assessment methodology, annual assessment amount, any maximum permitted annual assessments and special penalty assessments. Any changes from the initial assessment basis described in the preceding paragraph will be made in consultation with the MFDA and if IPC and MFDA are unable to agree on such changes the matter will be immediately reported to the relevant members of the CSA. The IPC shall provide the relevant CSA members with a current copy of the method of assessments and notify such members 30 days prior to making any changes to the method of assessing MFDA members. The basis on which the IPC will operate and co-ordinate its affairs with the MFDA will be governed by an agreement(s). This agreement will contemplate a dispute resolution mechanism (prior to reference to the CSA) which will be a formal, non-binding procedure to facilitate a fair and efficient resolution of any issues that may arise.

#### **4.4 Line of Credit**

IPC will establish a line of credit or similar facility with one or more institutional lenders in an aggregate amount of not less than \$25 million. This amount together with funds available to IPC from MFDA and member assessments will ensure that the initial aggregate funding available to IPC will not be less than \$30 million. MFDA and IPC expect a credit facility to be available for the commencement of coverage. The credit facility may be secured by a general security interest in respect of the assets of IPC in favour of its lender(s). In addition, MFDA will guarantee the obligations of IPC to its lenders and undertake to assess its members as required in order to permit IPC to meet its borrowing obligations. The obligations of MFDA to the lenders will be secured by an assignment of any assessment receivables from members that may be required or made. The credit facility will be available for a period not to exceed 364 days but will be extendable at the option of the lenders on sufficient notice periods to permit IPC to establish replacement credit facilities if all or a portion of the initial facility is terminated. As indicated in section 4.1 the size of the fund maintained by IPC will be reviewed on a periodic basis. As the size of the funds maintained by IPC increases by way of assessments over the next few years – thereby increasing the total resources available to IPC for coverage – the continued need for all or a portion of the credit facility will also be reviewed.

#### **4.5 Investment of IPC's Funds**

The directors of the IPC may invest and re-invest all cash, securities and other property belonging to the IPC that, under their uncontrolled discretion, they consider advisable. The Board will adopt investment policies for the management of the IPC's assets. Professional investment management advice may be retained. The general parameters of the investment policy are expected to include safety of principal and reasonable income while at the same time ensuring that sufficient liquid funds are available at any time to pay claims.

An investment committee to oversee the investment of the IPC assets will be considered if and when the size of the Fund assets warrants, there is a perceived need for the function to be delegated to a special committee or there is an advantage to the IPC by such management. The IPC does not expect any of these circumstances to arise for some time for a number of reasons. The IPC Board will in any event set the investment guidelines and the small size of the Board would likely render a separate committee unnecessary and duplicative. The policies will be conservative and will not likely require active management. For

example, a high proportion of the IPC assets will be tiered according to maturity in high grade government debt securities and simply rolled over on maturity.

#### 4.6 Auditors

The IPC will implement an appropriate accounting system, including a system of internal controls for maintaining the IPC. The IPC members will appoint an independent auditor to audit the annual financial statements in accordance with generally accepted auditing standards. The auditor shall hold office until the next annual meeting, provided that the directors may fill any casual vacancy in the office of auditor. The remuneration of the auditor will be fixed by the Board. At every annual meeting of members, the report of the directors, the financial statement and the report of the auditors will be presented and auditors appointed for the ensuing year. The role and performance of the auditor will be monitored by the audit committee.

### 5. CLIENT PROTECTION

#### CSA Criteria

- (a) **The MFDA IPC provides fair and adequate coverage for eligible customers of the MFDA members, and any other eligible customers that are agreed upon by the MFDA IPC and the Commission, regardless of the jurisdictions where they reside;**
- (b) **The MFDA IPC establishes and maintains fair and reasonable rules, regulations or policies for granting claims made under the MFDA IPC and pays eligible customer claims made pursuant to these policies, including, but not limited to:**
  - (i) **The MFDA IPC establishes and maintains rules, regulations or policies whereby persons not dealing at arm's length with the insolvent MFDA member, or who the MFDA IPC determines are, in whole or in part, responsible for the insolvency of the MFDA member, will not be covered by the MFDA IPC as eligible customers;**
  - (ii) **The MFDA IPC establishes within its rules, regulations or policies a fair and reasonable internal appeals mechanism whereby eligible customer claims that are not accepted for payment by the MFDA IPC staff, or by an appointed committee, are to be reconsidered by the Board of Directors;**
- (c) **The MFDA IPC's rules, regulations or policies described in paragraph (b) above do not prevent an eligible customer from taking legal action against the MFDA IPC, where the eligible customer has exhausted the MFDA IPC's internal claim review process and appeals process.**
- (d) **The MFDA IPC adequately informs customers of MFDA members of the principles and policies on which coverage will be available, including, but not limited to, the process for making a claim and the maximum coverage available per customer.**
- (e) **The MFDA IPC, in cooperation with the MFDA, establishes advertising guidelines within the MFDA's general advertising by-law that clearly establishes the parameters for advertising in order not to mislead the public.**
- (f) **In the event of an insolvency of a member of the MFDA, the MFDA IPC shall respond quickly and decisively, in accordance with its established rules, regulations or policies for assessing claims. The MFDA IPC shall also co-operate and provide reasonable assistance to the MFDA in administering an insolvency.**

#### 5.1 Extent of Protection

As indicated in this application, the primary purpose of IPC is to provide protection to eligible customers of MFDA members if securities, cash and other property held in their account with a member are not available as a result of the member's insolvency.

The coverage principles in this respect will be similar in kind to that of the CIPF in Canada. Although the protection provided by the IPC is not insurance, many of the underwriting risks associated with insurance products are relevant to the IPC. Accordingly, the nature and extent of coverage must be related to the nature of the operations of MFDA members, the degree and kind of regulation to which they are subject and the financial resources available to pay for losses that may arise. As in the case of CIPF, the risk is insolvency risk. This means that the direct cause of the loss must relate to the insolvency of the MFDA member and not to other causes such as change of market values. In addition, the losses must relate to the customer account activity of the customer and not commercial relationships with the MFDA member that would not be considered normal customer

account transactions. For instance, a person who provides financing to the member would not be eligible for IPC coverage. It must also be established that the person claiming coverage has sufficient connection with the member to be considered a customer for regulatory purposes. The reason for this requirement is that the industry regulations primarily relate to customer account relationships and one of the ways in which the IPC will assess and underwrite risks is on the basis of such regulations being in effect and properly enforced. Eligibility criteria have been developed by the IPC and are attached as Exhibit C. The criteria are expected to be similar to those adopted by CIPF and pursuant to the *Bankruptcy and Insolvency Act*. A draft policy setting out the criteria is attached as Exhibit C and the final form and any amendments would be published by IPC from time to time for customer reference.

Coverage under the IPC will be for all eligible customers of an MFDA member regardless of the jurisdiction in which they reside (including whether or not it is a recognizing jurisdiction). The foregoing basis of coverage assumes that the IPC and MFDA will be able to assess risks and regulate the operations of members in every jurisdiction where they carry on business. If such regulatory oversight is not possible, coverage will not be available to customers of those members in the jurisdictions where suitable regulation by the MFDA cannot be assured. In Canada, MFDA is able to fully and directly regulate the business of its members to the extent of its by-laws and Rules in all provinces and territories except Quebec.

In Quebec, MFDA has negotiated a Co-operative Agreement with the Autorité des marchés financiers ("Autorité") and the Chambre de la sécurité financière. The agreement provides for the basis on which the Autorité, Chambre and MFDA will cooperate in the regulation of MFDA's members in Quebec, particularly in respect of prudential matters that relate to the solvency of members. MFDA and IPC are satisfied that the Agreement provides for a satisfactory basis on which MFDA and IPC can be assured that MFDA members will be regulated according to MFDA's Rules while respecting at the same time the jurisdiction of the Autorité and Chambre in Quebec. A separate application has been made by MFDA to members of the CSA for approval of the agreement.

Although MFDA expects to be able to conduct prudential regulation of its members in Quebec under the Co-operative Agreement, MFDA IPC coverage for customers with accounts in Quebec of MFDA members will not be provided initially. One of the specific stated premises of the agreement is that there be co-ordination of MFDA member customer protection between the parties as well as the Autorité (formerly the Fonds d'indemnisation des services financiers and the body in Quebec that provides compensation to financial consumer victims of fraud, fraudulent tactics or embezzlement by a Quebec registrant with whom they dealt). A separate agreement is contemplated for this purpose but discussions as to the effect and content of the agreement have not been completed. In the event of an insolvency of an MFDA member carrying on business in Quebec and elsewhere and which has customers with accounts in Quebec who have incurred losses, arrangements between MFDA IPC and the trustee in bankruptcy as to the co-ordination of the administration of the member's estate under the *Bankruptcy and Insolvency Act* (Canada) will have to be made.

Assessments will be collected on the basis of MFDA being able to regulate in the expected jurisdictions where its members carry on business. If MFDA is not able to regulate in all such jurisdictions and members withdraw from membership in MFDA or separate their businesses, assessments in respect of coverage prior to commencement of MFDA IPC coverage will be returned to members on an equitable basis. As indicated above, coverage to customers with accounts in Quebec will not be available initially and, accordingly, IPC assessments will not be made in respect of assets under administration in Quebec attributable to such customers.

MFDA and MFDA IPC expect to continue discussions with the Autorité in 2005 to co-ordinate their respective customer protection for MFDA members operating in Quebec. For the purposes of defining whether a customer dealing in Quebec with a member is eligible for IPC coverage, the location of the customer's account with the member is expected to be determinative. The actual residency of the customer and the jurisdiction in which the member holds the customer's assets may be irrelevant.

## **5.2 Type of Loss Covered**

The experience of CIPF and other comparable compensation plans has been that while many losses can readily be determined as eligible for coverage, there are many claims that are less certain. It is important, therefore, for the IPC to state clearly to members and the public the principles and policies on which coverage will be available.

As in the case of the provincial plans that have been referred to above and CIPF, coverage is discretionary in the sense that the directors of the IPC have the ultimate discretion to determine whether a claim should be paid or not according to the circumstances. If the claim is squarely within the criteria proposed, it would be expected that the IPC would readily make payment. However, there may be extenuating circumstances wherein a claim might be technically eligible but it would be unfair or abusive to make payment. The MFDA and IPC are satisfied that an independent board with public representation can be relied upon to make such decisions.

The losses which the IPC will expect to cover are to be all securities, cash and other property held by a member in a customer account and which are not available to the customer as a result of the member's insolvency. In the Initial Application, it was proposed that coverage be restricted initially to mutual fund securities and cash related to the purchase and sale of such

products. Other products were to be considered and recommended for coverage, as appropriate. MFDA and IPC are of the view that it is in the best interests of the public and MFDA members that expanded coverage be provided from that proposed in the Initial Application. There are a number of reasons for this view including the desire of members that coverage be similar to that of CIPF and the fact that participation in CIPF will be more easily accomplished if the coverages are similar. The review and comparison of the businesses and risks of MFDA members and investment dealers described in the introduction to this letter has satisfied MFDA and IPC that the increased coverage can be provided with the size of the fund increased to \$30 million as discussed in Section 4.1.

The securities or property to be covered by IPC must actually be held by the member in order for the coverage to apply. For instance, in the case of mutual fund securities, the securities are often held directly by the customer (i.e. in "client name") and the IPC would not protect that asset even though it may have been sold by the member to the customer. In such case, any loss to the customer of his or her property would not be caused by the insolvency of the MFDA member because it is not responsible to account to the customer for the property. On the other hand, if the member holds the securities (which usually means that they are registered in its name) and reports to the client that it is holding the investment for the customer, the IPC would be expected to compensate the customer for any loss if the investment were not available on the insolvency of the member. A member may hold property for a customer that relates to a client name investment such as cash intended to acquire a mutual fund to be held in client name or the proceeds of the sale of such a fund. Property held in that circumstance by a member would usually be accepted to be covered by IPC because the member is responsible for the property while it is in its possession.

In the course of their operations, MFDA members may hold different kinds of assets for their customers and all such property held at the relevant date of insolvency will generally be entitled to coverage. Cash held by a member may rise from transfers by a customer to the member for specific purchases, proceeds of sales of securities, interest payments on GICs and other distributions. MFDA members primarily deal in mutual fund securities but other securities may also be held by a member for its customers such as government incentive securities, government bonds, partnership units and other so-called exempt securities. Examples of other kinds of property held by a member for a customer include segregated funds (insurance contracts), bank deposits and receivables from third parties such as depositories. All such cash, securities and other property held by a member for a customer is generally eligible for coverage regardless of the authority or registration of the member to hold it.

### **5.3 Non-Mutual Fund Affiliates**

Many members of the MFDA have affiliates which distribute financial services and products such as insurance policies, deposit instruments, tax planning services, financial planning and others. The obligations of these affiliates to their customers, including customers who are also customers of the MFDA member, are not covered by IPC. Members will be required to ensure that records, advertising and servicing activities differentiate for their customers the entity they are dealing with and the fact that IPC coverage only applies to business resulting in customer assets being held by the MFDA member.

### **5.4 Limits on Compensation**

The limit on IPC coverage per customer account is \$1 million. Each customer's accounts will be aggregated as one general account to the extent the accounts are held in the same capacity and circumstances. Registered plan accounts such as RRSPs, RIFFs, LIRAs, etc. are separate accounts and not aggregated with a customer's general account, but are aggregated themselves. Accordingly, the coverage limits per customer would be \$1 million each for the customer's aggregated general and aggregated registered plan accounts: see draft IPC policy attached as Exhibit C for details.

### **5.5 Exclusions from Coverage**

The IPC will establish and maintain policies whereby persons not dealing at arm's length with the insolvent MFDA member, or who the IPC determines are, in whole or in part, responsible for the insolvency of the MFDA member, will not be covered by the IPC as eligible customers: see draft IPC policy attached as Exhibit C for details.

### **5.6 IPC Adequacy**

The target size of the IPC assets has been determined by agreement between the MFDA and the IPC (see section 4 above). Annually the IPC directors will review and consult with the MFDA Board as to the adequacy of the IPC assets and recommend to the MFDA Board any changes it considers necessary or advisable.

### **5.7 Publicity**

The IPC will be expected to make known to the public the existence and limits of the coverage that it provides. One aspect of this kind of publicity is to ensure that customers are clear as to the kind of coverage available and that they are not under the impression that protection is available when in fact it is not. In particular, advertising requirements and restrictions will be developed and imposed by MFDA Rule on members pursuant to which clear disclosure will be made of the facts that organizations associated with the member or using a similar name may not be covered by the IPC. MFDA's proposed Rule in

this regard is attached as Exhibit D. This Rule will be supplemented by an MFDA policy describing the basis on which members may refer to IPC coverage: see Exhibit E. In addition, the fact of the IPC's coverage and dissemination of public information in that regard enhances the mutual fund industry and is generally regarded as being beneficial and in the public interest.

The IPC will be expected to provide brochures describing its coverage to the public as well as publishing any of its coverage policies and criteria and other information available. These publications may be available through members or on a website maintained by the IPC and/or MFDA. The IPC is expected to work with MFDA members to ensure that the existence of the IPC and the scope of its coverage is accurately understood by the public, MFDA members and customers of MFDA members.

## **5.8 Claims Process**

The IPC will establish policies that provide for a fair and reasonable internal appeals mechanism whereby eligible customer claims that are not accepted for payment by the IPC staff, or by an appointed committee, are to be reconsidered by the Board of Directors. An eligible customer is not precluded from taking legal action against the IPC where the eligible customer has exhausted the IPC's internal claim review process and appeals process.

The insolvency of mutual fund dealers is often administered by a trustee in bankruptcy or court appointed receiver and the IPC would expect to have procedures that could be co-ordinated with the statutory or court ordered process. Initial decisions as to coverage for particular claims may be made either by IPC staff, designated agents or by the directors individually or by sub-committee. Customers will be entitled to have initial decisions denying coverage reviewed by directors, individually or in sub-committee, who were not involved in the prior decision. As long as the number of IPC directors is three, it is expected that a single director (in consultation with staff or a trustee in bankruptcy) will make initial determinations of claims, with the other two directors being available for a review or appeal. All decisions will be objective and consistent with previous IPC decisions according to the policies and coverage procedures from time to time. The directors may determine that the review is to be on a written record or permit attendance in person by the claimant.

## **6. FINANCIAL AND OPERATIONAL VIABILITY (INCLUDING RISK MANAGEMENT)**

### **CSA Criteria**

- (a) The MFDA IPC has sufficient financial resources for the proper performance of its functions.**
- (b) The MFDA IPC shall ensure that is it satisfied with the process to assess and contain risk of insolvency of MFDA members, taking into account the size of its assets and the level of assessments. Such process may include, but is not limited to, the following:**
  - (i) maintenance of minimum standards in the areas of: capital requirements; customer accounts; audits and questionnaires; field examinations; books and records; internal controls insurance; segregation; early warning system; reportable conditions; and most stringent rules; and**
  - (ii) monitoring and assessing the MFDA's process in ensuring that its members are in compliance with prudential regulations and any established minimum standards, and the MFDA's process in monitoring the on-going financial condition of its members. Such monitoring and assessment may include conducting examinations of the MFDA's process and examinations of members of the MFDA.**

### **6.1 Funding**

The funding and assessment plans of IPC as described in Sections 4.1 and 5.6 of this application are designed to ensure that IPC will have sufficient financial resources for the proper performance of its functions.

### **6.2 Operations and Risk**

In conducting its operations and managing insolvency risks of MFDA members, the IPC will rely primarily on the adequacy of the MFDA's prudential regulation and oversight of the CSA members which have recognized it or exert jurisdiction over its activities. The MFDA will agree not to change its prudential standards without prior notice to the IPC and providing the IPC an adequate opportunity to comment. The MFDA will advise the IPC on the MFDA's member review methodology and procedures. In addition, the MFDA will report to the IPC any circumstances involving a member that may be in financial difficulty.

The IPC believes that establishing minimum standards and conducting oversight of the MFDA's review of its members with respect to compliance with such minimum standards is not initially a necessary risk management tool for IPC. Under the arrangements with the MFDA, IPC will be able to carryout member reviews in certain circumstances.

The IPC will rely both on information provided by the MFDA and knowledge of circumstances otherwise obtained to determine that an MFDA member is in financial difficulty. The circumstances in which a member may be in financial difficulty can vary widely, but both the IPC, the MFDA and their respective staff and advisors have experience in identifying certain conditions or activities that may indicate financial difficulties. In particular, the MFDA has implemented an early warning system which will require members to report information relating to their financial condition that will alert both the MFDA and the IPC. In addition, the IPC will require that the MFDA provide immediate notice to the IPC of certain conditions in respect of a member that may affect IPC and the fund.

### **6.3 Member Reviews**

While the IPC will usually rely on the MFDA to conduct reviews of MFDA members for IPC purposes, the IPC reserves the right to conduct reviews of MFDA members in particular situations where IPC has concerns about the integrity of the fund or possible claims. The IPC Board will be entitled to conduct reviews for the purposes described above, but efforts will be made not to duplicate the functions of the staff of the MFDA. The IPC Board would request the MFDA staff or independent advisors to perform such reviews according to the criteria of the IPC and to report to the Board. Depending on the circumstance the degree of expertise may vary, but if there is the prospect of member insolvency, it may be necessary to rely on qualified professionals or other regulators in order to respond quickly and decisively as necessary. The ability of the IPC to conduct such member reviews will be provided for in an agreement to be made between MFDA and IPC and the By-laws of the MFDA.

### **6.4 Information Sharing Arrangements**

The IPC will require information to assess not only whether the prudential standards and operations of the MFDA are appropriate for the coverage provided and risks incurred by the IPC, but also to deal with particular members which may be in financial difficulty. With respect to the former, the agreement(s) between the MFDA and the IPC will address general risk containment and the directors of the IPC may initiate discussions with the MFDA on any relevant subject. With respect to the latter specific risks to individual members, the IPC will have access to quarterly (or monthly) financial filings by members, information on early warning notices under MFDA Rules, meetings with MFDA staff and notice from the MFDA if any member may be in financial difficulty. This information collectively is expected to enable the IPC to assess whether the risks incurred by the IPC are adequately addressed by the MFDA and its Rules. If changes are necessary as a result of experience in the initial years of the IPC's operations and the MFDA as a self-regulatory organization, discussion can be initiated between the IPC, the MFDA, members of the CSA and other interested parties including MFDA members representatives. The risk assessment by the IPC is based in large part on the standards for members as set out in the by-laws and rules of the MFDA which have been (and will continue to be) reviewed and approved by members of the CSA. The MFDA will agree that any such by-laws or rules that relate to prudential standards for members will not be changed without prior notice to the IPC and the opportunity for the IPC to comment.

Information sharing arrangements between the MFDA and the IPC will be negotiated and entered into on the basis that their terms will ensure that IPC can fulfil its mandate and manage risks to the public and Plan assets on a reasonable basis. There are no legal constraints to the kind and amount of information that can be made available to the IPC by the MFDA. MFDA By-law 24 authorizes the MFDA to enter into information sharing arrangements of the kind contemplated and all relevant information in respect of the operations and business of MFDA members is permitted to be provided to the IPC. Such permission is expected to constitute consent for the purposes of any relevant privacy legislation. The content of information anticipated to be provided will relate primarily to the prudential regulation of MFDA members and risks to the public and the IPC as a result of member insolvency. It is expected that certain core relevant information will be provided as a matter of course by the MFDA to the IPC, but the IPC or its directors and staff will be able to request access to any other relevant information available to the MFDA. Such requests may be made on a "spot" basis or when the IPC is aware of circumstances where the public and the IPC assets may be at risk because of the activities or financial condition of a member. The MFDA will agree to immediately inform the IPC in the event that a member is in financial difficulty.

### **6.5 Administration**

The adopted roles and functions of the IPC will require administrative support. The intention is to minimize the administrative burden but certain minimum functions will have to be performed and at times, as in the case of a member insolvency or participation in the development of regulatory policy, the administrative demands will be high.

The primary responsibility for the management of the affairs of IPC as a corporation rests with the Board of Directors. The role of the Board, however, is to set policy direction for the IPC and to oversee senior management. The initial establishment of the IPC will likely require that the directors play a more active role in the conduct of the affairs of the IPC than they may do when the IPC is well established with mature operations. It has been proposed that a member of the Board, who may be the Chair, would dedicate more day-to-day management time to the initial operations of the IPC and as a public spokesperson for the IPC.

The IPC, as a corporation under the CCA, may appoint officers including the Chair of the Board, a president and possibly others such as a secretary. However, these roles are not expected to require full time attention. The initial recommendation for the

IPC is that it contract the services of the MFDA for certain functions such as secretarial and those of a controller with the intention that within two or three years at least one dedicated staff employee may be hired by the IPC, if needed. The need for further staff will be assessed over time.

The IPC may retain as needed professional advice including legal, actuarial and other consulting services. In addition, the IPC will be required to appoint an auditor to audit and report on annual financial statements which have been prepared by management. The role and performance of the auditor will be monitored by the audit committee. In addition, the auditor may provide staff and administrative services as required.

The administration of member insolvencies including the review and payment of eligible customer claims is potentially the greatest administrative role IPC and its board will have. In the event of an insolvency, it is necessary that actions be taken promptly and decisively and technical expertise and experience is required. In such circumstances, IPC would expect to retain assistance from trustees in bankruptcy, legal and accounting advice and, likely, support from other organizations such as CSA members and CIPF.

## **7. REPORTING TO SECURITIES COMMISSIONS**

### **CSA Criteria**

- (a) **The MFDA IPC provides the Commission with reports, documents or information, as reasonably requested by the Commission or their staff. The Commission and the MFDA IPC may review and revise such reporting requirements as necessary on an on-going basis.**
- (b) **The MFDA IPC immediately notifies the Commission of:**
  - (i) **any Reportable Conditions (as defined below) with respect to a MFDA member of which the MFDA IPC has been notified. Such Reportable Conditions mean any conditions which in the opinion of the official designated by the MFDA to be responsible for prudential regulation could give rise to payments being made out of the MFDA IPC, including any conditions which have contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:**
    - (1) **inhibit an MFDA member from promptly completing securities transactions, promptly segregating clients' securities as required or promptly discharging its responsibilities to clients, other MFDA members or other creditors;**
    - (2) **result in material financial loss;**
    - (3) **result in material misstatements of the MFDA member's financial statements; or**
    - (4) **result in violations of the minimum record requirements to an extent that could reasonably be expected to result in the conditions described in paragraphs (1), (2) or (3) above.**
  - (ii) **any MFDA member who has withdrawn or has been expelled from participation in the MFDA IPC.**
- (c) **The MFDA IPC files with the Commission, within 90 days after its fiscal year-end, its financial statements for the fiscal year prepared in accordance with Generally Accepted Accounting Principles, and a report by an independent auditor on its financial statements in accordance with generally accepted auditing standards.**
- (d) **The MFDA IPC cooperates with the Commission and the MFDA, as reasonably requested, by sharing information regarding the MFDA IPC and MFDA members.**

### **7.1 General**

The IPC will provide the appropriate members of the CSA with the information referred to in the Criteria.



## 8. RULEMAKING

### CSA Criteria

- (a) The By-laws, rules, regulations, policies, procedures, practices and other similar instruments (the "Rules") of the MFDA IPC are designed to:
  - (i) ensure the going concern of MFDA members;
  - (ii) ensure reasonable funding of the MFDA IPC and assessments to MFDA members, without creating significant barriers to the mutual fund dealer industry and without compromising investor protection;
  - (iii) ensure the maintenance of a reasonable Plan size to afford protection for clients of MFDA members;
  - (iv) ensure that its business is conducted in an orderly manner so as to afford protection to investors.
- (b) The Rules of the MFDA IPC shall not :
  - (i) be contrary to securities legislation;
  - (ii) permit unreasonable discrimination between customers of MFDA members and between MFDA members; or
  - (iii) impose any burden on competition that is not necessary or appropriate in furtherance of securities legislation.
- (c) The Rules of the MFDA IPC ensure that its business is conducted in an orderly manner so as to afford protection to investors.

### 8.1 General

The rules, regulations and policies of the IPC will relate to investor protection and the means of raising and maintaining funds to pay losses. They will not govern the affairs of members directly as that function is primarily the responsibility of the MFDA and the members of the CSA. However, the MFDA will not change its rules relating to prudential regulation without giving the IPC the opportunity to comment. The IPC's requirements and criteria relating to such matters as coverage, amounts, eligibility, size of funds, kinds of losses, etc. will all be developed in consultation with, or with the approval of, the MFDA and, where appropriate, the CSA. As a practical matter, the process of making Plan policies will be consultative and involve MFDA Board and staff, MFDA members directly, staff of the CSA, and the IPC Board members. This process is familiar in the development of self-regulatory organization rules in Canada.

## 9. SUBMISSIONS

The IPC and MFDA respectfully submit that the proposed structure, policies and operations of IPC satisfy the proposed Criteria and draft Terms and Conditions and request that the IPC be approved as customer protection plan under the applicable securities legislation referred to at the beginning of this letter. The IPC and MFDA consent to the publication of this application for public comment by any of the Commissions.

Yours very truly,

*signed "L.A. Wright"*  
Chair  
MFDA Investor Protection Corporation

*"L. Waite"*  
President and Chief Executive Officer  
Mutual Fund Dealers Association of Canada

**EXHIBIT A**

Industry Canada            Industrie Canada  
Canada                      Loi sur les  
Corporations Act        corporations canadiennes

**C A N A D A**

**LETTERS PATENT**

WHEREAS an application has been filed to incorporate a corporation under the name

**MFDA Investor Protection Corporation/  
Corporation de protection des investisseurs de l'ACFM**

THEREFORE the Minister of Industry by virtue of the powers vested in him by the Canada Corporations Act, constitutes the applicants and such persons as may hereafter become members in the corporation hereby created, a body corporate and politic in accordance with the provisions of the said Act. A copy of the said application is attached hereto and forms part hereof.

Date of Letters Patent – November 14, 2002

GIVEN under the seal of office of the Minister of Industry.

"•"

for the Minister of Industry

File Number: 412319-1

**APPLICATION FOR INCORPORATION OF A CORPORATION  
WITHOUT SHARE CAPITAL UNDER PART II OF THE  
CANADA CORPORATIONS ACT**

**TO THE MINISTER OF INDUSTRY CANADA:**

**I**

The undersigned hereby apply to the Minister of Industry Canada for the grant of a charter by letters patent under the provisions of Part II of the Canada Corporations Act constituting the undersigned, and such others as may become members of the Corporation thereby created, a body corporate and politic under the name of

**MFDA Investor Protection Corporation/  
Corporation de protection des investisseurs de l'ACFM**

The undersigned have satisfied themselves and are assured that the proposed name under which incorporation is sought is not the same or similar to, the name under which any other company, society, association or firm as, in existence is carrying on business in Canada or is incorporated under the laws of Canada or any province thereof or so nearly resembles the same as to be calculated to deceive and that it is not a name which is otherwise on public grounds objectionable.

**II**

The applicants are individuals of the full age of eighteen years with power under law to contract. The name, the address and the calling of each of the applicants are as follows:

Donald A. Leslie Businessman 125 Tutela Heights Brantford, Ontario N3T 5L6	Martin L. Friedland Professor 77 Belsize Drive Toronto, Ontario M4S 1L3
S. Robert Munroe Businessman 384 Centennial Pkwy Delta, British Columbia V4L 1K7	

The said applicants will be the first directors of the Corporation.

**III**

The purposes of the Corporation are:

1. To provide protection to eligible clients of members ("Members") of the Mutual Fund Dealers Association of Canada ("MFDA") who have incurred losses as a result of the insolvency of an MFDA Member in the absolute discretion of the directors in accordance with the policies and criteria published by the Corporation from time to time.
2. To receive, invest, hold, disburse or expend assets and property of any kind and from any source whatsoever for the objects and purposes of the Corporation.
3. To make assessments, or charge fees, levies, disbursements, costs or other amounts on, MFDA Members directly through MFDA or in any other manner in order to raise sufficient funds to maintain the operations of the Corporation and to provide protection to clients of Members as aforesaid.
4. To participate in or manage the administration of the affairs of insolvent Members with or without other participants or organizations in the capital markets in Canada and elsewhere including, without limitation, entering into such agreements or arrangements as the Corporation may consider necessary or desirable with the MFDA, securities regulatory authorities, self-regulatory organizations, governments and their agencies, or other organizations concerned with the distribution of financial products and services and the operation of capital markets in Canada and elsewhere.
5. To do all such other things as may be necessary or incidental to the furtherance of the foregoing objects and purposes.

**IV**

The operations of the Corporation may be carried on throughout Canada and elsewhere.

**V**

The place within Canada where the head office of the Corporation is to be situated is the City of Toronto, in the Province of Ontario.

**VII**

In accordance with Section 65 of the Canada Corporations Act, it is provided that, when authorized by by-law, duly passed by the directors and sanctioned by at least two-thirds of the votes cast at a special general meeting of the members duly called for considering the by-law, the directors of the Corporation may from time to time:

- (i) borrow money upon the credit of the Corporation;
- (ii) limit or increase the amount to be borrowed;
- (iii) issue debentures or other securities of the Corporation;
- (iv) pledge or sell such debentures or other securities for such sums and at such prices as may be deemed expedient; and
- (v) secure any such debentures, or other securities, or any other present or future borrowing or liability of the Corporation, by mortgage, hypothec, charge or pledge of all or any currently owned or subsequently acquired real and personal, movable and immovable, property of the Corporation, and the undertaking and rights of the Corporation.

Any such by-law may provide for the delegation of such powers by the directors to such officers or directors of the Corporation to such extent and in such manner as may be set out in the by-law.

Nothing herein limits or restricts the borrowing of money by the Corporation on bills of exchange or promissory notes made, drawn, accepted or endorsed by or on behalf of the Corporation.

**VII**

The directors of the Corporation may invest and re-invest any and all cash, securities and other property belonging to the Corporation from time to time in investments that in their uncontrolled discretion they consider advisable.

VIII

The by-laws of the Corporation shall be those filed with the application for letters patent until repealed, amended, altered or added to.

IX

The Corporation is to carry on its operations without pecuniary gain to its members and any profits or other accretions to the Corporation are to be used in promoting its objects. No part of any income of the Corporation will be available for the personal benefit of any member of the Corporation. In the event of the dissolution, wind-up, liquidation or other termination of the Corporation or the protection fund maintained by it, the property of the Corporation shall be distributed at such time or times as the directors may determine to any organization which (a) is established or operates for not-for-profit purposes and on a basis which qualifies it as being not subject to tax in accordance with the *Income Tax Act* (Canada), and (b) has as a principal object the furtherance in the public interest of the efficiency, safety and competitiveness of the Canadian capital markets.

DATED at the City of Toronto, in the Province of Ontario as of the 21 day of October, 2002.

*"D.A. Leslie"*  
Donald A. Leslie

*"M.L. Friedland"*  
Martin L. Friedland

*"S.R. Monroe"*  
S. Robert Munroe

**EXHIBIT B**

**MFDA Investor Protection Corporation /  
Corporation de protection des investisseurs de l'ACFM**

**BY-LAW NUMBER 1**

**BE IT ENACTED** as a by-law of **MFDA Investor Protection Corporation / Corporation de protection des investisseurs de l'ACFM** (the "Corporation"), which was incorporated under the *Canada Corporations Act* (the "Act"), as follows:

**PART 1 - CONDITIONS OF MEMBERSHIP**

1.1 **Membership.** Membership in the Corporation shall consist only of members of the board of directors of the Corporation (the "Board"). Each member of the Corporation shall have equal voting rights.

1.2 **Termination of Membership.** The membership of a member shall terminate upon his or her resignation or removal from office as a director of the Corporation.

**PART 2 - FEES AND ASSESSMENTS**

2.1 **Imposition of Fees and Assessments.** Subject to Section 2.2, the Corporation may from time to time impose or prescribe such fees, levies, assessments or other charges on or in respect of persons who are members of the Mutual Fund Dealers Association of Canada ("MFDA"). The Corporation may make such arrangements for the notification to, and collection from, such persons of any such fees, levies or assessments imposed either directly or indirectly through the MFDA. The amount, nature and basis of any such fees, levies and assessments may be determined by the Board in its sole discretion in a manner and an amount sufficient to further the objects of the Corporation and maintain its operations.

2.2 **Consultation with MFDA.** As of the commencement of its protection of customers of insolvent members of MFDA, the Corporation and MFDA shall have agreed as to the desirable size of the fund to be maintained, the methodology for assessments and assessment amounts. Any change to such agreement (and changes thereafter) as proposed by the Corporation shall be made in consultation with MFDA and if agreement with MFDA as to proposed changes has not been reached, the matter will be immediately reported to the relevant member(s) of the Canadian Securities Administrators (or any successor thereof). Nothing in this Section 2.2 shall prevent the Corporation exercising its authority under Section 2.1 in order to permit the Corporation to meet its obligations to its lenders or to satisfy claims incurred from eligible customers of MFDA members that exceed the assets available to the Corporation.

**PART 3 - HEAD OFFICE**

3.1 **Head Office.** Until changed in accordance with the Act, the head office of the Corporation shall be in the City of Toronto, in the Province of Ontario.

**PART 4 - BOARD OF DIRECTORS**

4.1 **Composition of Board.** The property and business of the Corporation shall be managed by a board consisting of an odd number of directors of not less than 3 and not more than 11 directors. The Board shall be composed of individuals who are either: (i) directors, officers or employees of the MFDA or of members of the MFDA ("Industry Directors"); or (ii) Public Directors (who shall be individuals who are not disqualified by the criteria set out below); such that the number of Industry Directors shall be equal to the number of Public Directors, less one. The Chair shall be eligible as a Public Director as long as he or she (i) holds no other office with the Corporation, (ii) is not an employee of the Corporation, or (iii) performs no management or executive functions on behalf of the Corporation in respect of its operations after the earlier of (A) the third anniversary of the date of approval or recognition of the Corporation as a customer protection plan and (B) the date the Corporation first hires its own executive officers or management employees. The appointment of Industry Directors and nomination of Public Directors shall be made bearing in mind appropriate and timely regional representation and, in the case of Industry Directors, experience with various aspects of the nature of the business carried on by Members of the MFDA. The number of directors shall be determined from time to time by a resolution passed at a meeting of the members of the Corporation. Directors must be individuals who are at least 18 years of age with power under law to contract. A majority of the number of directors in office at any time, provided that there is at least one Industry Director present and one Public Director present, shall constitute a quorum. For the purposes of the By-law "Public Director" means a director:

- (a) who is not a current director (other than a Public Director), officer or employee of, or of an associate or affiliate of:
  - (i) the Corporation;
  - (ii) the MFDA; or
  - (iii) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
- (b) who is not a current director, partner, significant shareholder, officer, employee or agent of a member, or of an associate or affiliate of a member, of:
  - (i) the MFDA;
  - (ii) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
- (c) who is not a current employee of a federal, provincial or territorial government or a current employee of an agency of the Crown in respect of such government;
- (d) who is not a current member of the federal House of Commons or member of a provincial or territorial legislative assembly;
- (e) who has not, in the two years prior to election as a Public Director, held a position described in (a)-(d) above;
- (f) who is not:
  - (i) an individual who provides goods or services to and receives direct significant compensation from, or
  - (ii) an individual who is a director, partner, significant shareholder, officer or employee of an entity that receives significant revenue from services the entity provides to, if such individual's compensation from that entity is significantly affected by the services such individual provides to,the Corporation, the MFDA or a member of the MFDA; and
- (g) who is not a member of the immediate family of the persons listed in (a)-(f) above.

For the purposes of this definition:

- (i) "significant compensation" and "significant revenue" means compensation or revenue the loss of which would have, or appear to have, a material impact on the individual or entity;
- (ii) "significant shareholder" means an individual who has an ownership interest in the voting securities of an entity, or who is a director, partner, officer, employee or agent of an entity that has an ownership interest in the voting securities of another entity, which voting securities in either case carry more than 10% of the voting rights attached to all voting securities for the time being outstanding.

**4.2 First Directors.** The applicants for incorporation shall become the first directors of the Corporation whose term as members of the Board shall continue until such time as the MFDA shall designate or appoint the initial Industry Directors and initial Public Directors who may be all or any of such applicants or any other person qualified in accordance with Section 4.1 and who shall then become the only directors of the Corporation until their successors are elected or appointed.

**4.3 Term.** The directors shall serve for a term of three years and, subject to the provisions of this Section 4.3, the terms of each of the Industry Directors and Public Directors shall be staggered. The terms of the initial Industry Director(s) and Public Directors designated or appointed in accordance with Section 4.2, or any other directors elected or appointed or an increase in the number of directors, shall be determined by the Corporation to ensure staggered terms of one, two or three years, as the case may be, of members of the Board of Directors composed in accordance with Section 4.1. The directors may be re-elected or re-appointed for one additional three-year term following the initial term.

**4.4 Election of Public Directors.** Subject to Section 4.2, Public Directors shall be elected by the Board at any time the office of a Public Director is vacated. At such time as a Public Director's office is vacated, the Board's nominating committee shall, as soon as is reasonably practicable, nominate an individual who satisfies the criteria set out in Section 4.1 for election as

a Public Director. The Board shall, at the meeting following the receipt of a nomination for Public Director, vote on the election of such nominee.

4.5 **Appointment of Industry Directors.** At such time as an Industry Director's office is vacated, the MFDA shall be entitled to nominate an Industry Director to fill such vacancy. Upon the MFDA advising the directors of the Corporation of the nomination of one or more individuals as an Industry Director, such individuals shall be considered by the Board of the Corporation and either accepted or rejected as a director of the Corporation. In the event that any person nominated by the MFDA is not appointed by the Board as a director, the MFDA shall be entitled to nominate further individuals until an appointment is made. If after a reasonable time from the occurrence of a vacancy MFDA has not nominated a person as an Industry Director to fill such vacancy, the Board of directors may appoint a person to fill the vacancy.

4.6 **Chair.** The directors shall elect from among themselves a Chair who may be either a Public Director or Industry Director, provided that the first Chair shall be appointed by the MFDA from among the first directors. The Chair will serve until his or her office is vacated in accordance with Section 4.7.

4.7 **Vacancies.** The office of director shall be automatically vacated:

- (a) if a director shall resign such office by delivering a written resignation to the secretary of the Corporation;
- (b) if the director is found by a court to be of unsound mind;
- (c) if the director becomes bankrupt;
- (d) if at a special general meeting of members a resolution is passed by 2/3 of the votes cast by the members present at the meeting that the director be removed from office;
- (e) if the term of a director expires in accordance with Section 4.3;
- (f) on death; and
- (g) the director does not satisfy the applicable qualifications in paragraph 4.1.

4.8 **Retiring Director.** Unless the office of a director has been automatically vacated pursuant to Section 4.7, a director shall remain in office until the dissolution or adjournment of the meeting at which a successor is elected or appointed.

4.9 **Place of Meeting and Notice.** Meetings of the Board may be held at any time and place to be determined by the directors provided that 48 hours written notice of such meeting shall be given, other than by mail, to each director. Notice by mail shall be sent at least 14 days prior to the meeting. There shall be at least four meetings per year of the Board. No error or omission in giving notice of any meeting of the Board or any adjourned meeting of the Board shall invalidate such meeting or make void any proceedings taken thereat and any director may at any time waive notice of any such meeting and may ratify, approve and confirm any or all proceedings taken or had thereat. Each director is authorized to exercise 1 vote. Notwithstanding the foregoing or anything contained herein, any director may, if in the opinion of the Chair or the President of the Corporation the financial condition of a member of the MFDA is such that immediate action by the directors may be required, call for a meeting of directors to consider the action to be taken. Three hours' prior notice of such meeting by telephone or other electronic communication to each director shall be required to be given, but no notice shall be required where all of the directors are in attendance personally or by telephone or other electronic communication in the manner referred to in this Section 4.9.

4.10 **Meetings by Teleconference.** Directors may hold meetings by teleconference or by other electronic means that permit all persons participating in the meeting to hear each other.

4.10.1 If all or not less than 2/3 of the directors of the Corporation consent thereto generally or in respect of a particular meeting, a director may participate in a meeting of the Board or of a committee of the Board by means of such conference telephone or other electronic communications facilities to which all directors have equal access and as permit all persons participating in the meeting to hear and communicate with each other, and a director participating in such a meeting by such means is deemed to be present at the meeting.

4.10.2 At the commencement of each such meeting the secretary of the meeting will record the names of those persons in attendance in person or by electronic communications facilities and the chair will determine whether quorum is present. The chair of each such meeting shall determine the method of recording votes thereat, provided that any director present may require all persons present to declare their votes individually. The directors shall take such reasonable precautions as may be necessary to ensure that such communications facilities are secure from unauthorized interception or monitoring.

4.11 **Resolutions.** Resolutions will be passed by a majority of the participating directors by a verbal vote recorded by the secretary, unless the Act or these by-laws otherwise provide. If permitted by law, a resolution consented to in writing by all of the directors or a committee of directors shall be effective as if passed at a meeting of directors or of the committee.

4.12 **Remuneration of Directors.** Directors may receive remuneration at a level as may be determined by the Board.

4.13 **Agents and Employees.** The Board may appoint such agents and engage such employees as it shall deem necessary from time to time and such persons shall have such authority and shall perform such duties as may be prescribed by the Board at the time of such appointment.

4.14 **Remuneration of Officers, Agents, Employees and Committee Members.** A reasonable remuneration of all officers, agents and employees and non-industry committee members shall be fixed by the Board by resolution.

4.15 **Mail Ballots.** Where attendance by a director at a meeting of the Board, whether in person or by teleconference or other electronic means, is not possible, a director may vote at such a meeting by way of mail ballot. Any votes received by mail ballot after the time of the meeting shall not be counted for the purposes of the meeting. The mail ballot shall only be counted provided that the motion on the floor at the meeting is identical to that contained in the mail ballot and all background material available to directors at the meeting has been made available in advance to directors exercising their vote by mail ballot. A mail ballot cannot replace a director for the purposes of establishing quorum. Any director voting by mail ballot must comply with Part 5 of the By-law prior to the meeting at which the mail ballot will be counted if such director has not already done so at an earlier meeting of the Board.

#### **PART 5 - INTEREST OF DIRECTORS IN CONTRACTS**

5.1 (a) **Conflict of Interest.** Any director of the Corporation who:

- (i) is a party to a material contract or proposed material contract with the Corporation, or
- (ii) is a director or officer of or has a material interest in any body corporate or business firm, whether direct or indirect, that is a party to a material contract or proposed material contract with the Corporation,

shall disclose in writing or have entered in the minutes, the nature and extent of such director's interest in such material contract or proposed material contract with the Corporation.

(b) The disclosure required by (a) above, shall be made:

- (i) at the meeting at which a proposed contract is first considered;
- (ii) if the director was not then interested in a proposed contract, at the first meeting after such director becomes so interested; or
- (iii) if the director becomes interested after a contract is made, at the first meeting held after the director becomes so interested.

(c) If a contract or a proposed contract is one that, in the ordinary course of carrying on the Corporation's non-pecuniary purpose or purposes, would not require approval by the directors or members, a director shall disclose in writing the nature and extent of the director's interest at the first meeting held after the director becomes aware of the contract or proposed contract.

(d) A director referred to in sub-paragraph (a) above is liable to account for any profit made on the contract by the director or by a corporate entity or business firm in which the director has a material interest, unless

- (i) the director disclosed the director's interest in accordance with sub- paragraphs (b) or (c) above or (f) below;
- (ii) after such disclosure the contract was approved by the directors or members; and
- (iii) the contract was reasonable and fair to the Corporation at the time it was approved.

Notwithstanding the foregoing, director who (1) has made a declaration of the director's interest in a contract or a proposed contract and (2) has not voted in respect of such contract contrary to the prohibition contained in sub-paragraph (e) below, (if such prohibition applies), is not accountable for any profit realized by such



contract to the Corporation or any of its members or creditors by reason only of such director holding that office or of the fiduciary relationship thereby established.

- (e) A director referred to in sub-paragraph (a) above shall not vote on any resolution to approve the contract, unless the contract is an arrangement by way of security for money lent to or obligations undertaken by the director for the benefit of the Corporation.
- (f) For the purposes of this paragraph 5.1, a general notice to the directors by a director declaring that the person is a director or officer of or has a material interest in a body corporate or business firm and is to be regarded as interested in any contract made therewith, is a sufficient declaration of interest in relation to any contract so made.
- (g) A contract is not void by reason only of the failure of a director to comply with the provisions of this paragraph 5.1 but the court may upon the application of the Corporation or a member, set aside a contract in respect of which a director has failed to comply with the provisions of this paragraph 5.1, and the court may make any further order it thinks fit.

#### **PART 6 - PROTECTION OF OFFICERS AND DIRECTORS**

6.1 **Limitation of Liability.** No past or present member of the Board of Directors or any committee or sub-committee thereof or of the Corporation, officer, employee or agent shall be liable for the acts, receipts, neglects or defaults of any other of such persons, or for joining in any receipt or other act for conformity, or for any loss, damage or expense happening to the Corporation through the insufficiency or deficiency of title to any property acquired for or on behalf of the Corporation, or for the insufficiency or deficiency of any security in or upon which any of the moneys of the Corporation shall be invested, or for any loss or damage arising from the bankruptcy, insolvency or tortious acts of any person with whom any of the moneys, securities or effects of the Corporation shall be deposited, or for any loss occasioned by any error of judgment or oversight on his or her part, or for any other loss, damage or misfortune whatever which shall happen in the execution of the duties of his or her office or in relation thereto; provided that nothing herein shall relieve any such person from the duty to act in accordance with the Act and the regulations thereunder or from liability for any breach thereof.

6.2 **Indemnity.** Each past and present member of the Board of Directors or any committee or sub-committee thereof or of the Corporation, officer, employee or agent of the Corporation, and any other person who has undertaken or is about to undertake any liability on behalf of the Corporation or any company controlled by it, and their heirs, executors and administrators, and estate and effects, respectively, shall from time to time and at all times, be indemnified and saved harmless out of the funds of the Corporation, from and against:

- (a) all costs, charges, fines and penalties and expenses which such Board, committee or sub-committee member, officer, employee, agent or other person sustains or incurs in or about or to settle any action, suit or proceeding which is threatened, brought, commenced or prosecuted against him or her, or in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him or her, in or about the execution of the duties of his or her office or in respect of any such liability; and
- (b) all other costs, charges and expenses which he or she sustains or incurs in or about or in relation to the affairs thereof, including an amount representing the value of time any such Board, committee or sub-committee member, officer employee, agent or other person spent in relation thereto and any income or other taxes or assessments incurred in respect of the indemnification provided for in this By-law, except such costs, charges or expenses as are occasioned by his or her own wilful neglect or default.

The Corporation shall also indemnify such persons in such other circumstances as the Act permits or requires. Nothing in this By-law shall limit the right of any person entitled to indemnity apart from the provisions of this By-law.

6.3 **Action, Suit or Proceeding Threatened, Brought, etc. by the Corporation.** Where the action, suit or proceeding referred to in Section 6.2.1 above is threatened, brought, commenced or prosecuted by the Corporation against a Board, Council, Panel committee or sub-committee member, officer, employee, agent or other person who has undertaken or is about to undertake any liability on behalf of the Corporation or any company controlled by it, the Corporation shall make application at its expense for approval of the court to indemnify such persons, and their heirs, executors and administrators, and estates and effects respectively, on the same terms as outlined in Section 6.2.

#### **PART 7 - INSURANCE**

7.1 **Insurance.** The Corporation may purchase and maintain insurance for the benefit of any person referred to in Section 6.2 against such liabilities and in such amounts as the Board may from time to time determine and are permitted by the Act.

## PART 8 - POWERS OF DIRECTORS

8.1 **Powers.** The directors of the Corporation may administer the affairs of the Corporation in all things and make or cause to be made for the Corporation, in its name, any kind of contract which the Corporation may lawfully enter into and, save as hereinafter provided, generally, may exercise all such other powers and do all such other acts and things as the Corporation is by its charter or otherwise authorized to exercise and do. Without limiting the generality of the foregoing, the Board may authorize the Corporation to contract with any person, corporation, trust or partnership to manage any or all of the affairs of the Corporation, on such terms as the Board may consider appropriate.

8.2 **Executive Committee.** The Board may appoint an executive committee composed of such even number of directors as the Board may determine, provided that the executive committee shall be composed of an equal number of Industry Directors and Public Directors. The executive committee shall exercise such powers as are authorized by the Board. Any executive committee member may be removed by a majority vote of the Board. Meetings of the executive committee shall be held at any time and place to be determined by the members of such committee provided that 48 hours written notice of such meeting shall be given, other than by mail, to each member of such committee. Notice by mail shall be sent at least 14 days prior to the meeting. A majority of the members of such committee, provided that there is at least one Industry Director present and one Public Director present, shall constitute a quorum. No error or omission in giving notice of any meeting of the executive committee or any adjourned meeting of the executive committee of the Corporation shall invalidate such meeting or make void any proceedings taken thereat and any member of such committee may at any time waive notice of any such meeting and may ratify, approve and confirm any or all proceedings taken or had thereat.

8.3 **Audit Committee.** The Board shall appoint an audit committee composed of three or more directors of which the majority shall be public directors. The audit committee shall be responsible for the review and approval of the Corporation's annual financial statements and such other functions as the Board shall determine by resolution.

8.4 **Nominating Committee.** The Board shall appoint a nominating committee which shall be composed of an equal number of Public Directors and Industry Directors. The Nominating Committee shall be responsible for the nomination of candidates for election as Public Directors and such other functions as the Board shall determine by resolution.

8.5 **Committees.** The Board may appoint other committees whose members will hold their offices at the will of the Board. The members of any other such committee need not be directors of the Corporation. The Board shall determine the duties of such committees.

8.6 **Expenditures.** The directors shall have power to authorize expenditures on behalf of the Corporation from time to time and may delegate by resolution to an officer or officers of the Corporation the right to employ and pay salaries to employees on behalf of the Corporation.

8.7 **Funding.** The Board shall take such steps as it deems requisite to enable the Corporation to acquire, accept, solicit, collect or receive fees, legacies, gifts, grants, settlements, bequests, endowments and donations of any kind whatsoever for the purpose of furthering the objects of the Corporation.

## PART 9 - BORROWING

9.1 **Borrowing Powers.** The Board may, subject to the provisions of the Letters Patent of the Corporation, from time to time:

- (a) borrow money upon the credit of the Corporation;
- (b) limit or increase the amount to be borrowed;
- (c) issue debentures or other securities of the Corporation;
- (d) pledge or sell such debentures or other securities for such sums and at such prices as may be deemed expedient;
- (e) secure any such debentures, or other securities, or any other present or future borrowing or liability of the Corporation, by mortgage, hypothec, charge or pledge of all or any currently owned or subsequently acquired real and personal, movable and immovable, property of the Corporation, and the undertaking and rights of the Corporation; and
- (f) delegate to such one or more of the officers and directors of the Corporation as may be designated by the directors all or any of the powers conferred by the foregoing sub-clauses (a), (b), (c), (d) and (e) of this section of this By-law to such extent and in such manner as the Board shall determine at the time of each delegation.

9.2 **Arrangements for Borrowing.** From time to time the Board may authorize any director, officer or employee of the Corporation or any other person to make arrangements with reference to the monies borrowed or to be borrowed as aforesaid and as to the terms and conditions of the loan thereof, and as to the securities to be given therefor, with power to vary or modify such arrangements, terms and conditions and to give such additional securities for any monies borrowed or remaining due by the Corporation as the Board may authorize, and generally to manage, transact and settle the borrowing of money by the Corporation.

#### **PART 10 - OFFICERS**

10.1 **Appointment.** The officers of the Corporation, which may include the offices of chair, president, vice-president, secretary and treasurer and any such other officers as the Board may by by-law determine, shall be appointed by resolution of the Board at the first meeting of the Board following the annual meeting of members in which the directors are elected or in any other manner as the Board may determine. A person may hold more than one office.

10.2 **Term and Removal of Officers.** The officers of the Corporation shall hold office for such terms as the Board may determine or until their successors are elected or appointed in their stead. Officers shall be subject to removal by resolution of the Board at any time.

#### **PART 11 - DUTIES OF OFFICERS**

11.1 **Chair.** The Chair shall be appointed pursuant to paragraph 4.6, shall preside at all meetings of the Corporation and of the Board, shall oversee the general management of the affairs of the Corporation.

11.2 **President.** The president may be the chief executive officer or chief operating officer of the Corporation, and shall, in the absence of the Chair, preside at all meetings of the Corporation and of the Board, shall have the general and active management of the affairs of the Corporation and shall see that all orders and resolutions of the Board are carried into effect, and shall perform such other duties as may be prescribed from time to time by the Board.

11.3 **Vice-President.** The vice-president shall, in the absence or disability of the president, perform the duties and exercise the powers of the president and shall perform such other duties as shall from time to time be imposed upon the vice-president by the Board.

11.4 **Treasurer.** The treasurer shall keep full and accurate accounts of all assets, liabilities, receipts and disbursements of the Corporation in the books belonging to the Corporation and shall deposit all monies, securities and other valuable effects in the name and to the credit of the Corporation in such chartered bank or trust company, or, in the case of securities, in such registered dealer in securities as may be designated by the Board from time to time. The treasurer shall also perform such other duties as may from time to time be directed by the Board.

11.5 **Secretary.** The secretary may be empowered by the Board, upon resolution of the Board, to carry on the affairs of the Corporation generally under the supervision of the officers thereof and shall attend all meetings and act as clerk thereof and record all votes and minutes of all proceedings in the books to be kept for that purpose. The secretary shall give or cause to be given notice of all meetings of the members and of the Board and shall perform such other duties as may be prescribed by the Board or by the president, under whose supervision the secretary shall be. The secretary shall be custodian of the seal of the Corporation, which the secretary shall deliver only when authorized by a resolution of the Board to do so and to such person or persons as may be named in the resolution.

11.6 **Duties of Officers.** The duties of all other officers of the Corporation shall be such as the terms of their engagement call for or the Board requires of them. Any officer of the Corporation may delegate their duties to one or more individuals.

#### **PART 12 - EXECUTION OF DOCUMENTS**

12.1 **Execution of Documents.** Contracts, documents or any instruments in writing requiring the signature of the Corporation, shall be signed by any two officers or directors or a combination thereof and all contracts, documents and instruments in writing so signed shall be binding upon the Corporation without any further authorization or formality. The directors shall have power from time to time by resolution to appoint persons on behalf of the Corporation to sign specific contracts, documents and instruments in writing. The directors may give the Corporation's power of attorney to any registered dealer in securities for the purposes of the transferring of and dealing with any stocks, bonds, and other securities of the Corporation. The seal of the Corporation when required may be affixed to contracts, documents and instruments in writing signed as aforesaid or by persons appointed by resolution of the Board.

### PART 13 - MEMBERS' MEETINGS

13.1 **Time and Place of Meetings.** Meetings of the members shall be held at least once a year or more often if necessary at the head office of the Corporation or at any place in Canada as the Board may determine and on such day as the said directors shall appoint.

13.2 **Annual Meetings.** At every annual meeting, in addition to any other business that may be transacted, the report of the directors, the financial statement and the report of the auditors shall be presented and auditors appointed for the ensuing year. The members may consider and transact any business either special or general at any meeting of the members. The Board or the president shall have power to call, at any time, a general or special meeting of the members of the Corporation. The Board shall call a special general meeting of members on written requisition of members carrying not less than 20% of the voting rights. A majority of the members entitled to vote will constitute a quorum at any meeting of members. Such majority shall be either present in person or represented by proxy at such meeting.

13.3 **Means of Meetings.** Members may hold meetings by teleconference or by other electronic means that permit all persons participating in the meeting to hear each other and communicate adequately. If all the members of the Corporation consent thereto generally or in respect of a particular meeting, a member may participate in a meeting of the members by means of such conference telephone or other electronic communications to which all members have equal access and as permit all persons participating in the meeting to hear and communicate with each other, and a member participating in such a meeting by such means is deemed to be present at the meeting. At the commencement of each such meeting the secretary of the meeting will record the names of those persons in attendance in person or by electronic communications facilities and the chair will determine whether quorum is present. The chair of each such meeting shall determine the method of recording votes thereat, provided that any member present may require all persons present to declare their votes individually. The chair of such meetings shall be satisfied that members have taken such reasonable precautions as may be necessary to ensure that such communications facilities are secure from unauthorized interception or monitoring.

13.4 **Resolutions.** Resolutions will be passed by a majority of the members entitled to vote by a verbal vote recorded by the secretary, unless the Act or these by-laws otherwise provide. If permitted by law, a resolution consented to in writing by all of the members shall be effective as if passed at a meeting of members.

13.5 **Notice.** 14 days' written notice shall be given to each voting member of any meeting of members. Notice of any meeting where special business will be transacted should contain sufficient information to permit the member to form a reasoned judgment on the decision to be taken. Notice of each meeting of members must state that the member has the right to vote by proxy.

13.6 **Voting of Members and Proxies.** Each member entitled to vote and who is present at a meeting shall have the right to exercise one vote. A member may, by means of a written proxy, appoint a proxyholder to attend and act at a specific meeting of members, in the manner and to the extent authorized by the proxy. A proxyholder need not be a member of the Corporation.

13.7 **Errors or Omissions in Giving Notice.** No error or omission in giving notice of any meeting or any adjourned meeting, whether annual or general, of the members of the Corporation shall invalidate such meeting or make void any proceedings taken thereat and any member may at any time waive notice of any such meeting and may ratify, approve and confirm any or all proceedings taken or had thereat. For purpose of sending notice to any member, director or officer for any meeting or otherwise, the address of the member, director or officer shall be that person's last address recorded on the books of the Corporation.

### PART 14 - MINUTES OF BOARD OF DIRECTORS MEETINGS

14.1 **Minutes of Board of Directors Meetings.** The minutes of the meetings of the Board and the minutes of the executive committee shall not be available to the general membership of the Corporation but shall be available to the Board, each of whom shall receive a copy of such minutes.

### PART 15 - FINANCIAL YEAR

15.1 **Financial Year.** The fiscal year-end of the Corporation shall be, in each fiscal year, the same day as the fiscal year-end of the MFDA.

### PART 16 - AMENDMENT OF BY-LAWS

16.1 **Amendment of By-laws.** The provisions of the by-laws of the Corporation not embodied in the letters patent may be repealed or amended by by-law enacted by a majority of the directors at a meeting of the Board and sanctioned by at least 2/3 of the members entitled to vote and participating at a meeting duly called for the purpose of considering the said by-law,

provided that (i) Section 2.2 of this By-law Number 1 may only be amended with the prior written consent of the MFDA, and (ii) the repeal or amendment of such by-laws shall not be enforced or acted upon until any required approval of the Minister of Industry Canada has been obtained.

#### **PART 17 - AUDITOR**

17.1 **Auditor.** The members shall at each annual meeting appoint an auditor to audit the accounts of the Corporation for report to the members at the next annual meeting. The auditor shall hold office until the next annual meeting, provided that the directors may fill any casual vacancy in the office of auditor. The remuneration of the auditor shall be fixed by the Board.

#### **PART 18 - BOOKS AND RECORDS**

18.1 **Books and Records.** The directors shall ensure that all necessary books and records of the Corporation required by the by-laws of the Corporation or by any applicable statute or law are regularly and properly kept.

#### **PART 19 - RULES, REGULATIONS, POLICIES AND AGREEMENTS**

19.1 **Rules, Regulations and Policies.** The Board may prescribe such rules, regulations and policies relating to client protection and determination of eligible claims and prudential regulation not inconsistent with these by-laws relating to the management and operation of the Corporation, as they deem expedient, including, without limiting to the generality of the foregoing, in respect of the:

- (a) terms of coverage ("Coverage") in respect of claims ("Claims") by clients of members of the MFDA;
- (b) method and details of assessment of members of the MFDA contemplated by Section 2.1;
- (c) investment of the Corporation's funds, including the funds required for the Corporation's operations or funds accumulated for the purposes of providing Coverage;
- (d) procedure for making Claims and for the payment of Claims; and
- (e) any other matter which the Board determines is advisable for the administration of its operations and in furtherance of its objects.

19.2 **Agreements.** The Corporation may enter into in its own name agreements or arrangements with any securities commission or regulatory authority, law enforcement agency, self-regulatory organization (including the MFDA), stock exchange, customer protection fund or other trading market or other organization regulating or providing services in connection with mutual funds, securities trading or other financial services located in Canada or any other country for the exchange of any information (including information obtained by the Corporation pursuant to its authority or otherwise in its possession) and for other forms of mutual assistance for market surveillance, investigation, enforcement and other regulatory purposes relating to trading in securities or mutual funds, or the provision of financial services in Canada or elsewhere

#### **PART 20 - INTERPRETATION**

20.1 **Interpretation.** In these by-laws and in all other by-laws of the Corporation hereafter passed, unless the context otherwise requires, words importing the singular number shall include the plural number and vice versa, and references to persons shall include firms and corporations.

**EXHIBIT C**

**MFDA INVESTOR PROTECTION CORPORATION  
COVERAGE POLICY – [• 2005]**

**POLICY**

The coverage by MFDA IPC of losses suffered by customers of insolvent MFDA members is in the discretion of the Board of Directors of MFDA IPC. Subject to the ability of the Board of Directors to determine otherwise, the exercise of such discretion is intended to be in accordance with the terms of this Policy.

**DEFINITION OF CUSTOMERS**

A customer considered eligible for protection by MFDA IPC shall be any customer of an MFDA member having an approved securities account used solely for the purpose of transacting securities business directly with the insolvent member on account of securities, other property (such as segregated insurance funds) and cash balances received, acquired, borrowed or held for the customer. An approved securities account is any account opened in accordance with the rules governing new accounts prescribed by or under the MFDA or any Canadian securities legislation. Such accounts are to be fully disclosed in the records of the insolvent member and are normally evidenced by receipts, contracts and statements that have been issued by the member.

MFDA maintains on its website at [www.mfda.ca](http://www.mfda.ca) a list of members whose eligible customers are entitled to protection subject to the terms of this Policy.

MFDA is not recognized as a self-regulatory organization in the Province of Quebec and assessments for MFDA IPC funding are not made in respect of assets under administration of Members in Quebec. Accordingly, customers with accounts in Quebec at MFDA members, and whose assets held by MFDA members in Quebec are not subject to such assessment, will not be entitled to protection by MFDA IPC except as the Board of Directors of MFDA IPC shall otherwise in its discretion determine.

A customer shall be an individual, a corporation, a partnership, an unincorporated syndicate, an unincorporated organization, a trust, a trustee, an executor, an administrator or other legal representative but shall not include:

- i) a domestic or foreign securities or mutual fund dealer registered with a Canadian securities commission or foreign equivalent;
- ii) any individual or corporation to the extent that such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the insolvent member such that the claim represents five percent or more of any class of equity security of the insolvent member, or any individual who has a claim which is subordinated to the claims of any or all creditors of the insolvent member;
- iii) a general partner or director of the insolvent member;
- iv) a limited partner with a participation of five percent or more in the net assets or net profits of the insolvent member;
- v) someone with the power to exercise a controlling influence over the management or policies of the insolvent member;
- vi) a clearing corporation;
- vii) a customer of an institution, securities dealer or other party dealing with a member on an omnibus basis; and
- viii) a person who caused or materially contributed to the insolvency of a member.

Persons who deal with members through accounts used for business financing purposes are not eligible for coverage in respect of such accounts. The Directors may also determine that persons are not customers entitled to protection if they do not deal at arm's length with (i) an insolvent member or (ii) with a person who is excluded as a customer.

Securities, cash, segregated funds or other property that is not held by the member, or not recorded in a customer's account as being held by a member, such as mutual fund securities that are registered directly in the name of the customer with the mutual fund company, are not eligible for MFDA IPC coverage.

## LIMITS OF COVERAGE

The determination of the amount of financial loss suffered by a customer of an insolvent member for the purposes of payment by MFDA IPC and the maximum limits of such payments shall be in accordance with this Policy. In addition, the Board of Directors may exercise its discretion, in respect of determining customers eligible for protection and the amount of financial loss suffered, in a manner that is consistent with the right and extent to which a person may be entitled to claim against the customer pool fund of a member under the *Bankruptcy and Insolvency Act* (Canada), subject to other restrictions in this Policy and the sole discretion of the Directors to determine protection by MFDA IPC. The Directors may rely on the trustee in bankruptcy or the receiver under applicable law in determining the amount and validity of claims of a customer and for the purpose of calculating financial loss.

In the case of any question or dispute as to the amount of the financial loss incurred by a customer for the purposes of payment by MFDA IPC, and the maximum amounts to be paid to a customer, the interpretation of the Board of Directors of this Policy shall be final and conclusive. The Board of Directors reserves the right in the appropriate circumstances to authorize any payments in a manner other than as prescribed in this Policy.

### Determination of Customer Losses

The financial loss of a customer in respect of which the Directors may authorize payment by MFDA IPC shall be determined as at the applicable date (as fixed by the Board of Directors) after taking into account the delivery of any securities or property to which the customer is entitled and the distribution of any assets of the insolvent member. Accordingly, the maximum amount of securities, cash and other property which MFDA IPC may pay to a customer shall be calculated as the balance of the customer's financial loss as a result of the insolvency of the member net of such deliveries or payments. The Board of Directors may in its discretion reduce the amount of the financial loss of a customer for the purposes of authorizing payments by the amount of compensation the customer may receive from any other source. To be eligible for coverage, the claim by any customer must be filed with MFDA IPC or the trustee in bankruptcy or similar official of the insolvent member within 180 days of the date of insolvency.

The date at which the financial loss of a customer is determined shall be fixed by the Directors as the date of bankruptcy of the member, if applicable, or the date on which, in the opinion of the Directors, the member became insolvent. The amount of securities delivered to a customer in satisfaction of a claim shall be the amount of securities to which the customer was entitled as at the date for determining financial loss without regard to subsequent market fluctuations. In lieu of satisfying a claim by the delivery of securities, cash in an amount equal to the value of the securities as at the date for determining financial loss may be paid to the customer even though the amount of such cash is not equal to the value of such securities as at the date of payment.

### Maximum Limits of Payments

The Board of Directors may authorize payments to be made to each customer considered eligible for protection by MFDA IPC who has suffered financial loss to a maximum amount of \$1,000,000 attributable to securities, cash and other property held by the member with respect to each of (i) the aggregate of all the customer's General Accounts and (ii) each type of aggregated Separate Account of the customer, as such General and Separate Accounts are determined by the Board of Directors. The amount of a customer's claim for cash will be reduced to the extent that the customer is entitled to deposit insurance in respect of all or any of the cash held for an account or to compensation in respect of other securities or property.

## GENERAL ACCOUNTS

Each account of a customer considered eligible for protection by MFDA IPC which is not a Separate Account shall be one of the General Accounts of such customer. All General Accounts of a customer, or any interest the customer may have therein, shall be combined or aggregated so as to constitute a single account of such customer for the purposes of determining the payments to be made to the customer. The interest of a customer in an account which is held on a joint or shared ownership basis shall be treated as if it were a Separate Account and combined with the General Accounts of the customer. An account held by a nominee or agent for another person as a principal or beneficial owner shall, except as otherwise provided in this Policy, be deemed to be the account of the principal or beneficial owner. The General and Separate Accounts that a customer has with a member will not be combined with the General and Separate Accounts that the same customer may have with another member, including another member who has an introducing / carrying agreement with the first member.

## SEPARATE ACCOUNTS

Each account of a customer held by it in the capacity or circumstance set out below shall be considered a Separate Account of the customer. Unless otherwise indicated below, each Separate Account held by a customer in the same capacity or circumstance shall be combined or aggregated so as to constitute a single Separate Account. The burden shall be on the customer to establish each capacity or circumstance in which the customer claims to hold Separate Accounts. An account of a

customer shall not be a Separate Account if it existed on the date of insolvency primarily for the purpose of increasing protection by MFDA IPC.

**Registered Retirement Plans:** accounts of registered retirement or deferred income plans such as registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), life income funds (LIFs), locked-in retirement accounts or plans (LIRAs or LIRSPs) and locked-in retirement income funds (LRIFs) established for the account of a customer (excluding spousal plans) which comply with the requirements under the Income Tax Act (Canada) for such plans and which have been accepted by the Minister under such Act, where the customer is entitled to the benefits of the plan. Accounts established with respect to a customer through the same or different trustees shall be combined and aggregated.

**Registered Education Savings Plans:** accounts of education savings plans which comply with the requirements under the Income Tax Act (Canada) for registered education savings plans and which have been accepted by the Minister under such Act, where the customer is the subscriber of the plan. Accounts established with respect to a customer through the same trustee shall be combined and aggregated by trustee, but not if established through different trustees.

**Testamentary Trusts:** accounts held in the name of a decedent, his or her estate or the executor or administrator of the estate of the decedent. Accounts of testamentary trusts held by the same executor or administrator shall not be combined or aggregated unless held in respect of the same decedent.

**Inter-vivos Trusts and Trusts Imposed by Law:** accounts of inter-vivos trusts which are created by a written instrument and trusts imposed by law. Such Separate Accounts of customers shall be distinct from the trustee, the settlor or any beneficiary.

**Guardians, Custodians, Conservators, Committees, etc.:** accounts maintained by a person as a guardian, custodian, conservator, committee or similar capacity in respect of which accounts such person has no beneficial interest. Such accounts held by the same person in any such capacity shall not be combined or aggregated unless held in respect of the same beneficial owner.

**Holding Corporation:** accounts of corporations controlled by a customer provided that the beneficial ownership of a majority of the equity capital of the corporation is held by persons other than the customer.

**Partnerships:** accounts of partnerships controlled by a customer provided that the beneficial ownership of a majority of the equity interests in the partnership is held by persons other than the customer.

**Unincorporated Associations or Organizations:** accounts of unincorporated associations or organizations controlled by a customer provided that the beneficial ownership in a majority of the assets of the association or organization is held by persons other than the customer.



**EXHIBIT D****MFDA PROPOSED AMENDMENTS TO RULE 2.7 – ADVERTISING AND SALES COMMUNICATIONS AND PROPOSED MFDA POLICY NO. 4 (“ADVERTISING RELATING TO MFDA IPC PARTICIPATION”)****1. OVERVIEW****(a) Current Rules**

MFDA Rule 2.7 sets out restrictions and requirements for advertising and sales communications issued by Members and their Approved Persons. Rule 2.7 is based closely on the form and substance of By-Law 29.7 of the Investment Dealers Association of Canada (“IDA”) and was approved by the relevant securities commissions which have recognized MFDA as a self-regulatory organization.

**(b) The Issue**

The MFDA Investor Protection Corporation (“IPC”) will provide protection to eligible clients of MFDA Members if client property held by such Members is unavailable as a result of the insolvency of the Member. Client property eligible for protection under the MFDA IPC will generally comprise securities, cash and other investment products such as segregated insurance funds held by the Member. Securities or financial investment products acquired or held through and by affiliated or related organizations of a Member or an Approved Person in respect of a Member shall not be covered. Clear disclosure is required to ensure that customers are not misled into believing that protection is available when in fact it is not.

**(c) The Objective**

The objectives of the proposed amendments to MFDA Rule 2.7 and proposed MFDA Policy 4 (“Advertising Relating to MFDA IPC Participation”) are to ensure that customers of Members and the public are:

- (i) made aware of the nature and extent of the coverage available to them; and
- (ii) not misled into believing that MFDA IPC protection is applicable to them in circumstances where it is not, such as dealings by a customer with financial intermediary groups in which customers of some but not all of the group Members are entitled to MFDA IPC protection.

**(d) Effect of the Proposed Rule**

The proposed amendments and policy are intended to minimize the risk that the public and customers of MFDA Members may not accurately understand the scope of MFDA IPC coverage.

**2. DETAILED ANALYSIS****(a) Relevant History and Proposed Amendments**

At the time of the enactment of MFDA Rule 2.7 and the recognition of MFDA as a self-regulatory organization by the relevant securities commissions, the nature and extent of the customer protection by MFDA IPC had not been determined. In November 2002 MFDA IPC made an initial application to the relevant members of the Canadian Securities Administrators on the basis that coverage would be limited to \$100,000 per customer account in respect of losses of mutual fund securities and cash related to the purchase, sale and redemption of mutual funds. Since that time, the MFDA and the directors of MFDA IPC have determined that customer protection by MFDA IPC should be expanded to \$1,000,000 per customer account in respect of the loss of securities, cash and other property held by an MFDA Member for a customer suffered in the event of the insolvency of the Member. Losses caused by other reasons such as the change in market value of mutual fund securities, unsuitable investments or default of an issuer of mutual funds are not covered. In addition, investments which are held by any person other than a Member, including directly by a customer, are not covered. The coverage provided by MFDA IPC is intended to be similar to the coverage provided by Canadian Investor Protection Fund to customers of insolvent securities dealers, subject to certain customers of MFDA members not being entitled to MFDA IPC protection and the exercise of the discretion of the Board of Directors of MFDA IPC.

There are a number of reasons for the scope of coverage provided. First, MFDA Members and their approved representatives may be involved in a wide range of financial services and the scope of protection to customers must be limited. In particular, individual salespersons who are approved as representatives of a Member may also distribute a wide range of financial products (insurance, GICs, financial planning, tax advice, etc.) directly in their personal capacity or through associated enterprises.

Second, the financial resources of MFDA IPC in its first years of operation are to be increased from its initial proposal and the restriction of coverage to relatively low risk mutual fund securities held by a Member is no longer necessary. Third, MFDA and MFDA IPC intend to pursue the possibility of MFDA Members participating in CIPF and similar protection parameters between the two protection funds are desirable. Notwithstanding the foregoing, there is no reliable data available to MFDA or MFDA IPC to accurately measure and assess the risks associated with the various kinds of financial products and services that MFDA Members may deal in. MFDA and MFDA IPC will continue to monitor the businesses of their Members to ensure that coverage is appropriate for the range of products and risks covered.

It is important that the terms and extent of MFDA IPC coverage be communicated clearly to customers of MFDA Members. MFDA IPC does not have direct jurisdiction over Members of MFDA and, accordingly, the basis on which MFDA IPC and MFDA impose advertising and sales communication restrictions on Members in respect of coverage must be through Rules made by MFDA itself.

The proposed amendments and policy require Members to make disclosure to their customers of protection by the MFDA IPC and regulate the manner in which such disclosure is made. In particular, Members will be required to use the prescribed MFDA IPC official symbol together with the MFDA IPC official explanatory statement on account statements and confirmations. The MFDA explanatory statement advises customers of the fact that the MFDA IPC protects losses within specified limits and directs customers to the website and the MFDA IPC brochure.

MFDA is not recognized in the Province of Quebec and assessments for MFDA IPC funding are not made in respect of assets under administration of Members in Quebec. Accordingly, customers with accounts at MFDA Members in Quebec, whose assets held by MFDA Members in Quebec are not subject to such assessment, will not be entitled to protection by MFDA IPC, except as the Board of Directors of MFDA IPC shall otherwise in its discretion determine. Advertising and sale communications requirements and restrictions are intended to ensure that customers in jurisdictions where they may not be entitled to MFDA IPC protection are aware of such limitation on coverage.

The proposed amendments also require Members to use the prescribed MFDA IPC official symbol together with the MFDA IPC referral statement

- (i) at their business premises to which customers have access; and
- (ii) on advertisements.

The referral statement directs customers to a prescribed brochure (the "MFDA IPC official brochure") describing MFDA IPC coverage which the Members will be required to make available to customers.

The proposed amendments prohibit the use of the MFDA IPC official symbol, explanatory statement or referral statement in circumstances in which a Member is identified with a corporate group including affiliates or related persons, or other entities associated or affiliated with an Approved Person, which are not Members of the MFDA.

**(b) Issues and Alternatives Considered**

Other alternatives to the proposed amendments and policy were considered including the restricted coverage contemplated in the initial application for approval of MFDA IPC. The customer protection available to Members of the IDA through Canadian Investor Protection Fund ("CIPF") is intended as the model for MFDA IPC coverage. In the United States, customers of mutual fund dealers (which are not Securities Investor Protection Corporation (SIPC) dealers) acquiring mutual fund securities are not provided insolvency protection.

**(c) Public Interest Objective**

The MFDA believes that the proposed amendments and policy are in the public interest in that they will make customers and the public aware of the nature and extent of protection applicable to them and minimize the potential for confusion regarding MFDA IPC coverage.

**3. COMMENTARY**

**(a) Filing in Other Jurisdictions**

The proposed amendments will be filed for approval with the Alberta, British Columbia, Manitoba, Newfoundland, Nova Scotia, Saskatchewan and Ontario Securities Commissions.

**(b) Effectiveness**

The proposed amendments are simple and effective.

**(c) Process**

The proposed amendments to MFDA Rule 2.7 were developed by MFDA staff and have been approved by the MFDA's Board of Directors.

**4. SOURCES**

MFDA Rule 2.7 (Advertising and Sales Communications).

**5. OSC REQUIREMENT TO PUBLISH FOR COMMENT**

The MFDA is required to publish for comment the proposed Rule so that the issue referred to above may be considered by **Ontario Securities Commission** staff.

The MFDA has determined that the entry into force of this Rule would be in the public interest and is not detrimental to the capital markets. Comments are sought on the proposed Rule. Comments should be made in writing. One copy of each comment letter should be delivered on or prior to March 28, 2005, addressed to the attention of the Corporate Secretary, Mutual Fund Dealers Association of Canada, 121 King St. West, Suite 1600, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 King Street West, Toronto, Ontario M5H 3S8. The MFDA will make available to the public on request all comments received unless an author specifically requests confidentiality. Access to confidential comments will not be permitted except as may be required by law.

Questions may be referred to:

Director of Policy  
Mutual Fund Dealers Association of Canada  
(416) 943-5836

## Proposed Amended MFDA Rule Relating to Advertising

### 2.7 ADVERTISING AND SALES COMMUNICATIONS

#### 2.7.1 Definitions

For the purposes of the By-laws and Rules:

- (a) "advertisement" includes television or radio commercials or commentaries, billboards, internet websites, newspapers and magazine advertisements or commentaries and any published material promoting the business of a Member and any other sales literature disseminated through the communications media;
- (b) "sales communication" includes records, video tapes and similar material, market letters, research reports, and all other published material, except preliminary prospectuses and prospectuses, designed for or use in presentation to a client or a prospective client whether such material is given or shown to them and which includes a recommendation in respect of a security.

#### 2.7.2 General Restrictions

No Member or Approved Person shall issue to the public, participate in or knowingly allow its name to be used in respect of any advertisement or sales communication in connection with its business which:

- (a) contains any untrue statement or omission of a material fact or is otherwise false or misleading, including the use of a visual image such as a photograph, sketch, drawing, logo or graph which conveys a misleading impression;
- (b) contains an unjustified promise of specific results;
- (c) uses unrepresentative statistics to suggest unwarranted or exaggerated conclusions, or fails to identify the material assumptions made in arriving at these conclusions;
- (d) contains any opinion or forecast of future events which is not clearly labelled as such;
- (e) fails to fairly present the potential risks to the client;
- (f) is detrimental to the interests of the public, the Corporation or its Members;
- (g) if applicable, does not clearly disclose that organizations associated legally or in business with the Member or using a similar name may not be covered by MFDA IPC; or
- (h) does not comply with any applicable legislation or the guidelines, policies or directives of the Corporation or any regulatory authority having jurisdiction over the Member.

#### 2.7.3 Review Requirements

No advertisement or sales communication shall be issued unless first approved by a partner, director, officer, compliance officer or branch manager who has been designated by the Member as being responsible for advertisements and sales communications.

#### 2.7.4 MFDA Investor Protection Corporation

- (a) **Definitions.** For the purposes of the By-laws and Rules:

"MFDA IPC" means the MFDA Investor Protection Corporation and "l'ACFM IPC" means Corporation de protection des investisseurs de l'ACFM;

"MFDA IPC official brochure" means any brochure or publication prescribed as such by the MFDA IPC for use by Members;

"MFDA IPC official explanatory statement" means the following statement in English or in French:

**"Customers' accounts are protected by MFDA Investor Protection Corporation within specified limits. For details, see [www.\\*](http://www.*) or the MFDA IPC's brochure."**

"[to come]"

"MFDA IPC official symbol" means the symbol, mark, logo or other designation prescribed or designated by Policy as such by the MFDA or the MFDA IPC for use by Members with the word "Member" appearing on top of the official symbol;

"MFDA IPC referral statement" means the following statement in English or French:

**"Member MFDA Investor Protection Corporation  
See official brochure for details"  
"Corporation de protection des investisseurs  
des membres de l'ACFM  
Voir la brochure officielle pour plus de détails"**

- (b) **Premises.** Each Member shall conspicuously display in a prominent place at each of its locations to which customers have access the MFDA IPC official symbol accompanied by the MFDA IPC referral statement. Each decal used shall contain the exact name of the Member and affiliates or related companies which are also Members of the MFDA IPC.
- (c) **Account Statements and Confirmations.** Each Member shall include on the front of each confirmation and account statement sent to a customer the MFDA IPC official symbol, accompanied by the MFDA IPC official explanatory statement in a print size not less prominent than the general text of the confirmation or statement, as the case may be.
- (d) **MFDA IPC Official Brochure.** Each Member shall provide the current version of the MFDA IPC official brochure in either English or French to:
  - (i) all new customers together with the New Account Application Form required pursuant to MFDA Rule 2.2.2; and
  - (ii) all customers of the Member at any time (including customers of the Member at the time this Rule comes into force) on request and by advising such customers in writing at least annually that the MFDA IPC official brochure is available to them on request or on the MFDA IPC website;
- (e) **Advertising.** Each Member shall include in any advertisement the words "Member MFDA IPC" and the MFDA IPC referral statement, together with, at the option of the Member, a reproduction of the MFDA IPC official symbol. Except as provided for in this paragraph (e), no Member shall display any symbol relating to the MFDA IPC other than the MFDA IPC official symbol or include any symbol, statement or explanation relating to the MFDA IPC or the Member's membership in the MFDA IPC in any advertisements other than the MFDA IPC official symbol together with the MFDA IPC referral statement. Use of the MFDA IPC official symbol in printed or visual materials or media shall be in a manner and size such that the visual impact of the official symbol shall not be greater than that of the Member's name, logo or identifying symbol where used in the same materials or medium or in the same location within the Member's premises.
- (f) **Jurisdictions Where Coverage Not Available.** The requirements of paragraphs (b), (c), (d) and (e) of this Rule 2.7.4 shall not apply in respect of customers with accounts at Members in Quebec, except as may be determined otherwise by the Board of Directors of MFDA IPC. Members with customers with accounts in Quebec shall use their best efforts to ensure that the manner in which they comply with this Rule 2.7.4 does not, or could not reasonably be expected to, mislead such customers into believing that MFDA IPC protection is available to them in circumstances where it is not.
- (g) **Members of MFDA IPC.** For the purposes only of complying with this Rule 2.7.4 and to the extent permitted by MFDA IPC from time to time, Members shall identify themselves as Members of the MFDA IPC.
- (h) **Corporate Groups.** The MFDA IPC official symbol, explanatory statement, or referral statement is prohibited in respect of any materials or circumstances in which a Member is identified with a corporate group including affiliates or related persons, or any entities associated or affiliated with an Approved Person, which are not Members of the MFDA IPC. This prohibition is applicable to, without limitation,
  - (i) consolidated reports and statements of a Member and its parent or affiliates (other than subsidiaries);
  - (ii) promotion or trade show booths or displays for more than one organization and not all participants named or identified in the booths or displays are not Members of MFDA IPC; and

- (iii) the use by Approved Persons together with trade or business names which relate to businesses in respect of which there is no MFDA IPC coverage;
- (i) **English / French Language.** Subject to applicable laws, a Member may comply with the requirements of this Rule in either the French or English language.
- (j) **Termination of Membership.** Upon the termination or suspension of its membership, each Member shall immediately cease using the MFDA IPC official explanatory statement, the MFDA IPC referral statement, the MFDA IPC official brochure or the MFDA IPC official symbol, and shall cease identifying itself as a Member of the MFDA IPC.
- (k) **Exemptions.** A Member or Approved Person may be exempted from all or part of the requirements of this Rule 2.7.4 to the extent prescribed by MFDA from time to time if, in the opinion of the MFDA in consultation with MFDA IPC, compliance with the requirements by the Member or Approved Person would be misleading or result in confusion as to the availability of coverage.

**EXHIBIT E**

**MFDA POLICY NUMBER •  
ADVERTISING RELATING TO MFDA IPC PARTICIPATION**

**[• 2005]**

**DISCLOSURE OF MEMBER COVERAGE**

Members of the Mutual Fund Dealers Association of Canada ("MFDA") are required to make disclosure to their customers of protection by the MFDA Investor Protection Corporation ("MFDA IPC") in accordance with Rule 2.7.4 of the MFDA. The Corporation has prescribed certain aspects of the extent and manner of this disclosure by this Policy. Reference should also be made to Rule 2.7.4 of the MFDA for details of these requirements, not all of which are reproduced in this Policy.

The purpose of Rule 2.7.4 and this Policy is to ensure that customers of Members and the public are:

- (a) made aware of the nature and extent of protection applicable to them; and
- (b) not misled into believing that MFDA IPC protection is applicable to them in circumstances where it is not, such as dealings by a customer with financial intermediary groups in which customers of some but not all of the group members are members of MFDA IPC or where the customer is in Quebec or the client's assets are not subject to MFDA IPC assessments.

The application and interpretation of this Policy shall be subject to the principles in (a) and (b) above, and the Corporation may make any final interpretation or determination as to this Policy and its application.

**MFDA IPC Official Symbol with Explanatory Statement**

The MFDA IPC official symbol together with the MFDA IPC official explanatory statement is required to be used by Members of the MFDA on account statements and confirmations sent to customers.

**MFDA IPC Official Symbol with Referral Statement**

The MFDA IPC official symbol together with the shorter MFDA IPC referral statement guiding customers to the MFDA IPC official brochure is required to be used by Members:

- at their business premises to which customers have access; and
- on advertisements.

Use of the MFDA IPC official symbol together with the MFDA IPC referral statement is optional in certain limited circumstances described under the heading "Optional Use in Advertising" below.

The MFDA IPC official symbol shall be in one of the following forms:

- (i) Member MFDA IPC
- (ii) Member  
[logo]
- (iii) Member MFDA Investor Protection Corporation
- (iv) Membre CPI ACFM
- (v) Membre  
[logo]
- (vi) Membre Corporation de protection des investisseurs de l'ACFM

Note: Use of the logo is mandatory in forms (ii) and (v) and is an optional addition in the other forms listed above. A bilingual logo may also be used.

[logo]

If the Member identifies other associations or memberships in its materials, the MFDA IPC official symbol shall be at least of the same print size and visual impact. The colour of the logo shall be a prescribed colour or black.

### **DISPLAY AT PREMISES**

Members are to conspicuously display the MFDA IPC official symbol in a prominent place at each of its premises to which customers have access. The MFDA IPC official symbol shall be accompanied by the MFDA IPC referral statement. Members shall comply with this requirement by use of the decal prescribed and made available by the MFDA IPC at the expense of the Member. The decal may be attached to doors, windows, plaques on counters or other similar visible surfaces. If in any location the Member also displays a sign or symbol of membership or affiliation with any regulatory organization, the MFDA IPC decal will be displayed in the same manner and immediately adjacent to such other sign or symbol. Members should ensure that the use and placement of a decal shall not cause, or be reasonably expected to cause, customers of another financial intermediary or institution to believe that they are entitled to MFDA IPC protection if they are not.

Premises at which the decal is to be displayed shall include all premises of the Member (including branch and sub-branch locations) if customers or potential customers have access to them and such access is utilized in the normal course of business. For instance, if customers are not normally permitted to attend at a sub-branch office, such as a residence of a salesperson, display of the decal is not required.

### **OPTIONAL USE IN ADVERTISING**

Use of the MFDA IPC official symbol together with the MFDA IPC referral statement by Members is optional in the following circumstances. Any such optional use of the MFDA IPC official symbol shall be subject to the principles, and interpretations and determinations of the Corporation, set out at the beginning of this Policy.

- Signs or plates in the office or attached to the building or buildings in which the Member's offices are located.
- Listings in directories.
- Classified or display advertisements relating to the recruitment of personnel.
- Printed advertisements less than 10 square inches in space.
- Advertisements by radio or telephone less than 30 seconds in time.
- Advertisements by television less than 15 seconds in time.
- Internal news wires.
- Press releases.
- Supplies such as stationery, envelopes and cheques.
- Promotional items such as calendars, matchbooks, pens, paperweights, etc.
- Telephone market reports.
- Research reports.
- Annual reports and statements of financial condition (which may be consolidated with subsidiaries).
- Market letters and similar communications.
- Promotion or trade show booths or displays.



**JURISDICTIONS WHERE COVERAGE NOT AVAILABLE**

Customers with accounts at Members in certain jurisdictions may not be entitled to protection by MFDA IPC. MFDA is not recognized in the Province of Quebec and, accordingly, customers with accounts at MFDA Members in Quebec will not be entitled to protection by MFDA IPC, except as the Board of Directors of MFDA shall otherwise in its discretion determine. Members should ensure that their compliance with MFDA Rule 2.7 with respect to advertising and sales communications and, in particular, Rule 2.7.4 does not mislead customers into believing that protection is available where it is not.

**EXEMPTIONS**

The By-laws and Rules of the MFDA provide for exemptions from certain advertising and other requirements as prescribed by the MFDA from time to time. The Corporation intends as a general approach to only consider and permit exemptions on a basis applicable to all Members and not on individual application. However, in extenuating circumstances application may be made to the President, Chief Operating Officer or Executive Vice President, Member Regulation of MFDA for relief from some or all of such advertising requirements. With respect to any specific exemption from the requirements of Rule 2.7.4, applicants will be expected to demonstrate that compliance with the requirements by the applicant would be misleading or result in confusion as to the availability of coverage. MFDA IPC will be consulted in respect of any request for an exemption.

**DRAFT**

**IN THE MATTER OF THE SECURITIES ACT, R.S.O. 1990, CHAPTER S.5, AS AMENDED (the "Act")**

**AND**

**IN THE MATTER OF REGULATION 1015 MADE UNDER THE ACT, R.R.O. 1990, AS AMENDED (the "Regulation")**

**AND**

**IN THE MATTER OF THE MFDA INVESTOR PROTECTION CORPORATION**

**AND**

**IN THE MATTER OF THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

**APPROVAL ORDER  
(Section 110 of the Regulation)**

**WHEREAS**, pursuant to section 110(1) of the Regulation, every dealer, other than a security issuer, shall participate in a compensation fund or contingency trust fund approved by the Commission and established by, among others, a self-regulatory organization;

**AND WHEREAS** the Mutual Fund Dealers Association of Canada (MFDA) and the MFDA Investor Protection Corporation (MFDA IPC) have applied for approval, pursuant to section 110(1) of the Regulation, of the MFDA IPC as a compensation fund for customers of mutual fund dealers that are members of the MFDA;

**AND WHEREAS** the MFDA IPC is established by the MFDA;

**AND WHEREAS** the Commission has recognized the MFDA as a self-regulatory organization under section 21.1 of the Act on February 6, 2001 (Recognition Order);

**AND WHEREAS** the terms and conditions of the Recognition Order refer to the establishment of the MFDA IPC;

**AND WHEREAS** members of the MFDA must contribute to the MFDA IPC by way of assessments pursuant to MFDA by-laws;

**AND WHEREAS** the MFDA IPC intends to provide protection to eligible customers of MFDA members on a discretionary basis to prescribed limits if securities, cash and other property held by any such member are unavailable as a result of the member's insolvency;

**AND WHEREAS** the MFDA IPC intends to commence coverage of customer accounts on •, 2005 (Coverage Date);

**AND WHEREAS** the MFDA IPC has entered into an agreement with the MFDA, pursuant to which the MFDA IPC will receive all information it deems necessary to ensure that the MFDA IPC can fulfil its mandate and manage risks to the public and MFDA IPC assets on a reasonable basis;

**AND WHEREAS** the MFDA IPC and the MFDA have agreed to the terms and conditions set out in Schedule "A";

**AND WHEREAS** the terms and conditions set out in Schedule "A" may be varied or waived by the Commission;

**AND WHEREAS**, based on the application of the MFDA and the MFDA IPC and the representations and undertakings the MFDA and the MFDA IPC have made to the Commission, the Commission is satisfied that the approval of MFDA IPC would not be prejudicial to the public interest;

The Commission hereby approves the MFDA IPC as a compensation fund pursuant to section 110 of the Regulation, subject to the terms and conditions set out in Schedule "A".

Dated •

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**SCHEDULE A**

**TERMS AND CONDITIONS**

**1. Corporate Structure and Purpose of the MFDA IPC**

The MFDA IPC has, and will continue to have, the appropriate legal authority to carry out its objective of providing compensation, in accordance with established by-laws, rules, regulations or policies of the MFDA IPC, to eligible customers of members of the MFDA on a discretionary basis to prescribed limits if customer property comprising securities, cash and other property held by such members (Customer Property) is unavailable as a result of the insolvency of such members.

**2. Corporate Governance**

- (a) To ensure diversity of representation, the MFDA IPC will ensure that:
- (i) its board of directors (Board) is comprised of individuals that represent the size, diversity, nature and regional distribution of the businesses of MFDA members and the interests of investors in order to provide a proper balance between the differing interests among MFDA members and investors; and
  - (ii) in recognition that the protection of the public interest is a primary goal of the MFDA IPC, its Board is comprised of an odd number of directors, the majority of which will be public directors.
- (b) For greater certainty, a public director is a director
- (i) who is not a current director (other than a public director of the MFDA IPC), officer or employee of, or of an associate or affiliate of:
    - (A) the IPC,
    - (B) the MFDA, or
    - (C) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
  - (ii) who is not a current director, partner, significant shareholder, officer, employee or agent of a member, or of an associate or affiliate of a member, of:
    - (A) the MFDA, or
    - (B) the Investment Funds Institute of Canada or the Investment Dealers Association of Canada;
  - (iii) who is not a current employee of a federal, provincial or territorial government or a current employee of an agency of the Crown in respect of such government;
  - (iv) who is not a current member of the federal House of Commons or member of a provincial or territorial legislative assembly;
  - (v) who has not, in the two years prior to election as a public director, held a position described in (i)-(iv) above;
  - (vi) who is not:
    - (A) an individual who provides goods or services to and receives direct significant compensation from, or
    - (B) an individual who is a director, partner, significant shareholder, officer or employee of an entity that receives significant revenue from services the entity provides to, if such individual's compensation from that entity is significantly affected by the services such individual provides to,the IPC, the MFDA or a member of the MFDA; and
  - (vii) who is not a member of the immediate family of the persons listed in (i)-(vi) above.
- (c) For the purposes of the above definition of public director:

- (i) “significant compensation” and “significant revenue” means compensation or revenue the loss of which would have, or appear to have, a material impact on the individual or entity;
  - (ii) “significant shareholder” means an individual who has an ownership interest in the voting securities of an entity, or who is a director, partner, officer, employee or agent of an entity that has an ownership interest in the voting securities of another entity, which voting securities in either case carry more than 10% of the voting rights attached to all voting securities for the time being outstanding.
- (d) Notwithstanding 2(b)(i)(A), above, the Chair shall be eligible as a public director as long as he or she
- (i) holds no other office with the MFDA IPC;
  - (ii) is not an employee of the MFDA IPC; or
  - (iii) performs no management or executive functions on behalf of the MFDA IPC in respect of its operations after the earlier of
    - (A) the third anniversary of the date of approval of the MFDA IPC as a compensation fund; and
    - (B) the date the MFDA IPC first hires its own executive officers or management employees.
- (e) The MFDA IPC’s governance structure will provide for:
- (i) fair and meaningful representation on its Board and any committees of its Board, having regard to the differing interests among MFDA members and investors;
  - (ii) appropriate representation of persons independent of the MFDA or any of its members or of any affiliated or associated company of such member on MFDA IPC committees and on any executive committee or similar body;
  - (iii) appropriate qualification, remuneration, conflict of interest provisions and limitation of liability and indemnification protections for directors and officers and employees of the MFDA IPC generally; and
  - (iv) an audit committee, the majority of which will be made up of directors that are public directors.
- (f) The MFDA IPC Board or MFDA IPC members will appoint independent auditors for the MFDA IPC, for the purpose of conducting an audit of the MFDA IPC’s annual financial statements.

**3. Funding and Maintenance of MFDA IPC**

- (a) The MFDA IPC will have a fair, transparent and appropriate process for setting fees, levies and assessments (collectively, the Assessments) for each MFDA member’s contribution. The Assessments will:
- (i) be allocated on an equitable basis among MFDA members; and
  - (ii) balance the need for the MFDA IPC to have sufficient revenues to satisfy claims in the event of an insolvency of an MFDA member and to have sufficient financial resources to satisfy its operations costs against the goal that there be no unreasonable financial barriers to becoming a member of the MFDA.
- (b) The MFDA IPC has provided the Commission with a current copy of the method of assessing MFDA members and will notify the Commission 30 days prior to making any changes to the method of assessment.
- (c) The MFDA IPC will make all necessary arrangements for the notification to MFDA members of the Assessments and the collection of the Assessments either directly from MFDA members or indirectly through the MFDA.
- (d) The MFDA IPC Board has determined that \$30 million, comprised of cash and credit facilities from institutional lenders, is an adequate initial fund size. The MFDA IPC Board will conduct an annual review, the first to be completed twelve months after approval and thereafter on a calendar year basis, of the adequacy of the level of assets, Assessment amounts and Assessment methodology and will ensure that the level of assets remains adequate to cover potential customer claims pursuant to section 4.
- (e) The MFDA IPC will immediately report to the Commission any actual or potential material adverse change in the level of MFDA IPC assets.

- (f) Any increases in fund size or changes to Assessments or Assessment methodology will be determined by the MFDA IPC Board after consultation with the MFDA. If the MFDA does not agree with the MFDA IPC's proposed changes, the MFDA IPC will immediately report such disagreement to the Commission. However, this will not prevent the IPC from imposing Assessments in order to permit the MFDA IPC to meet its obligations to its lenders or to satisfy claims incurred from eligible customers of MFDA members that exceed the assets available to the MFDA IPC.
- (g) Moneys in the MFDA IPC will be invested in accordance with rules, regulations and policies (collectively, the Investment Policies) approved by the MFDA IPC Board, who will be responsible for regular monitoring of the investments. The general parameters of the Investment Policies shall include safety of principal and a reasonable income while at the same time ensuring that sufficient liquid funds are available at any time to pay customer claims. The MFDA IPC shall provide the Commission with its current Investment Policies and will inform the Commission of any changes to the Investment Policies within thirty days of such changes.
- (h) The MFDA IPC will implement an appropriate accounting system, including a system of internal controls for maintaining MFDA IPC assets.

**4. Customer Protection**

- (a) The MFDA IPC will provide, on a discretionary basis, fair and adequate coverage, for all eligible customers of MFDA members, for customer losses of Customer Property resulting from the insolvency of an MFDA member.
- (b) Without limiting the foregoing, the MFDA IPC will provide, at a minimum, coverage of \$1,000,000 per separate account (as defined in the MFDA IPC Coverage Policy) of an eligible customer for Customer Property, where customer losses result from the insolvency of an MFDA member.
- (c) The MFDA IPC will offer coverage in a jurisdiction only if the requirements relating to risk management, prudent business conduct and practices and firm solvency that apply in that jurisdiction are not materially different from the requirements established by the MFDA IPC and/or the MFDA and the MFDA and the MFDA IPC are able to monitor and enforce their requirements in this regard.
- (d) The MFDA IPC has established and will maintain by-laws, rules, regulations and policies (collectively, the Coverage Policies) relating to customer coverage including, but not limited to:
  - (i) a definition of eligible customer and ineligible customer;
  - (ii) types of products covered and amount of coverage per eligible customer account;
  - (iii) a process for the review of claims that will be based on fairness to customers, expediency and cost efficiency and that will ensure that decisions by the MFDA IPC will be objective and consistent with prior decisions according to the Coverage Policies; and
  - (iv) a fair and reasonable internal appeals or review process whereby customer claims that are not accepted for payment by the initial reviewer(s) will be reconsidered by directors, either individually or in a sub-committee, who were not involved in the initial decision under review.
- (e) The Coverage Policies will not prevent a customer from taking legal action against the MFDA IPC in a court of competent jurisdiction in Canada, nor will the MFDA IPC contest the jurisdiction of such a court to consider a claim where the claimant has exhausted the MFDA IPC's internal appeals or review process.
- (f) The MFDA IPC will provide a current copy of the Coverage Policies to the Commission and the MFDA IPC will inform the Commission 30 days prior to implementing any changes to its Coverage Policies.
- (g) The MFDA IPC will adequately inform customers of MFDA members, either directly or indirectly through the MFDA, of the principles and policies on which coverage will be available, including, but not limited to, the process for making a claim and the maximum coverage available per customer account.
- (h) In the event of an insolvency of a member of the MFDA, the MFDA IPC will respond quickly and decisively, in accordance with its Coverage Policies, in assessing claims.
- (i) The MFDA IPC and the MFDA will co-operate and provide reasonable assistance to each other when a member firm is in or is approaching financial difficulty, or when either the MFDA IPC or the MFDA is administering an insolvency.

**5. Financial and Operational Viability**

- (a) The MFDA IPC has, and will maintain, sufficient financial and human resources for the proper performance of its functions including, but not limited to,
  - (i) assessing and managing risks to the public and to MFDA IPC assets;
  - (ii) administering any insolvencies, including the processing of customer claims;
  - (iii) setting and collecting of Assessments, including conducting reviews of the Assessment methodology;
  - (iv) maintaining an adequate fund size, including assessing the fund size on a regular basis; and
  - (v) day-to-day administrative work, including required reporting to the Commission.
- (b) The MFDA IPC will ensure that it has sufficient funds set aside and allocated to operating costs within 90 days of this order being granted.

**6. Risk Management**

- (a) The MFDA IPC will ensure it identifies and requests all necessary information from the MFDA, and the MFDA will provide such information, in order for the MFDA IPC to:
  - (i) fulfil its mandate and manage risks to the public and to MFDA IPC assets;
  - (ii) assess whether the prudential standards and operations of the MFDA are appropriate for the coverage provided and the risks incurred by the MFDA IPC; and
  - (iii) identify and deal with MFDA members that may be in financial difficulty.
- (b) While the MFDA IPC will usually rely on the MFDA to conduct reviews of MFDA members for MFDA IPC purposes, the MFDA IPC will reserve the right to conduct reviews of MFDA members in particular situations where the MFDA IPC has concerns about the integrity of the fund or possible claims.
- (c) The MFDA IPC will monitor risk management issues and will report to the Commission, on an annual basis, on how the MFDA IPC evaluated risks, what risk management issues were identified and how the MFDA IPC dealt with these issues. The annual report will also include an assessment by the MFDA IPC Board of the need for additional risk management tools.
- (d) As part of the first annual risk management review, the MFDA IPC will include a review of the different risks posed by different types of products and assess the appropriateness of offering coverage for all Customer Property.

**7. Reporting to the Commission**

- (a) The MFDA IPC will provide to the Commission any reports, documents or information requested by the Commission or Commission staff. The Commission or Commission staff and the MFDA IPC may review and revise such reporting requirements as necessary on an on-going basis.
- (b) The MFDA IPC will immediately notify the Commission where it has knowledge of:
  - (i) any conditions which in the opinion of the MFDA IPC could give rise to payments being made out of the MFDA IPC, including any conditions which have contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to:
    - (A) inhibit an MFDA member from promptly completing securities transactions, promptly segregating customers' securities as required or promptly discharging its responsibilities to customers, other MFDA members or other creditors,
    - (B) result in material financial loss,
    - (C) result in material misstatements of an MFDA member's financial statements, or

- (D) result in violations of the minimum record requirements to an extent that could reasonably be expected to result in the conditions described in paragraphs (A), (B) or (C) above;
- (ii) misconduct or apparent misconduct by an MFDA member or its registered or approved employees and others where investors, customers, creditors, MFDA members, or the MFDA IPC may reasonably be expected to suffer serious damage as a consequence thereof, including where the solvency of an MFDA member is at risk, fraud is alleged or there is a concern of deficiencies in supervision or internal controls; and
- (iii) the withdrawal or expulsion of any MFDA member from the MFDA.
- (c) The MFDA IPC will provide to the Commission a report detailing any action taken with respect to an MFDA member in relation to the member's insolvency. The report shall describe the circumstances of the insolvency, including a summary of the actions taken by the MFDA member, the MFDA and the MFDA IPC and any committee or person acting on behalf of such parties.
- (d) The annual audited financial statements of the MFDA IPC, prepared in accordance with generally accepted accounting principles, will be delivered to the Commission promptly after being approved by the MFDA IPC Board and no later than 120 days after the close of the MFDA IPC fiscal year.
- (e) The MFDA IPC shall provide a written report to, and will meet with, the Canadian Securities Administrators (CSA) or their representatives at least once a year to report on the MFDA IPC's operations and activities including, but not limited to:
  - (i) the MFDA IPC Board's annual review of the adequacy of the level of assets in the fund, Assessment amounts and the Assessment methodology;
  - (ii) MFDA IPC resources;
  - (iii) MFDA member firm failures and any resulting customer claims;
  - (iv) risk management issues; and
  - (v) the results of any reviews of MFDA members.

**8. Rules**

- (a) The MFDA IPC will establish by-laws, rules, regulations, policies, procedures, practices and other similar instruments (Rules) that:
  - (i) are not contrary to the public interest; and
  - (ii) are necessary or appropriate to govern all aspects of its business and affairs.
- (b) More specifically, the MFDA IPC will ensure that:
  - (i) the Rules are designed to:
    - (A) ensure the continued business viability of MFDA members,
    - (B) ensure reasonable funding of the MFDA IPC through Assessments to MFDA members, without creating unreasonable barriers to the mutual fund industry and without compromising investor protection,
    - (C) ensure the maintenance of a reasonable level of MFDA IPC assets to afford protection for eligible customers of MFDA members, and
    - (D) ensure that its business is conducted in an orderly manner so as to afford protection to investors;
  - (ii) the Rules shall not:
    - (A) be contrary to securities legislation,

- (B) permit unreasonable discrimination among customers of MFDA members and among MFDA members, or
- (C) impose any burden on competition that is not necessary or appropriate in furtherance of securities legislation.

**9. Agreement between the MFDA IPC and the MFDA**

The MFDA IPC and the MFDA have entered into an agreement, approved by the Commission, pursuant to which the MFDA IPC will, among other things, receive all information it deems necessary to ensure that the MFDA IPC can fulfil its mandate and manage risks to the public and to MFDA IPC assets on a reasonable basis. Such agreement, as may be amended from time to time, shall continue to be in force at all times. All amendments will be subject to prior Commission approval.

**10. Establishment of a Working Group**

- (a) The MFDA IPC will establish a working group consisting, at a minimum, of representatives of the MFDA IPC, the MFDA and mutual fund dealers (including representatives from both mutual fund dealers that hold client investments primarily in client name and mutual fund dealers that do not hold client investments primarily in client name), with representatives of the CSA as observers, to review various aspects of the MFDA IPC, including, but not limited to, the following:
  - (i) identification of the risks of mutual fund dealer failures leading to potential investor losses;
  - (ii) consideration of the size of fund that is appropriate having regard to:
    - (A) identified risks,
    - (B) amounts of Customer Property held in client name,
    - (C) amounts of Customer Property held in nominee name,
    - (D) average size of customer accounts,
    - (E) average cash flow of customer monies through the dealer, and
    - (F) other non-mutual fund products being covered under the fund;
  - (iii) the type of products that should be covered;
  - (iv) the appropriate coverage amount per customer account;
  - (v) assessment methodology, including whether it should be risk based;
  - (vi) the appropriate long term methods of funding the MFDA IPC; and
  - (vii) the types of risk management tools required by the MFDA IPC.
- (b) A written report of the working group's findings will be submitted to the MFDA IPC Board and to the Commission within one year from the date of Commission approval of the MFDA IPC.
- (c) The MFDA IPC Board will evaluate the working group's findings and will provide a written report of its evaluation to the Commission within 30 days of receipt of the working group's report.



**Summary of Public Comments  
Respecting  
Application for Approval of  
MFDA Investor Protection Corporation  
And  
Response of the MFDA and MFDA IPC**

On November 29, 2002, the Ontario Securities Commission (the "OSC") published for comment the Application (the "Initial Application") of the Mutual Fund Dealers Association of Canada (the "MFDA") and the MFDA Investor Protection Corporation (the "IPC") for the approval by the OSC of the IPC as a compensation fund, pursuant to subsection 110(1) of R.R.O. 1990, Regulation 1015, as amended, made under the Securities Act R.S.O. 1990, c.S.5, as amended. The Initial Application was published in Volume 25, Issue 48 of the Ontario Securities Commission Bulletin, dated November 29, 2002. The Application was simultaneously filed with the Executive Director of the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Securities Commission, the Manitoba Securities Commission and the Nova Scotia Securities Commission (together with the OSC, the "CSA Members") for approval, designation or consideration, as the case may be, of IPC by those CSA Members. The OSC has acted as the principal or lead CSA Member for the purposes of the Application and co-ordinating comments.

The Initial Application included a draft application for letters patent for IPC (the "Letters Patent"), draft by-law No. 1 of IPC (the "By-laws"), draft MFDA policy relating to IPC coverage (the "Coverage Policy"), proposed MFDA rule relating to IPC advertising (the "Advertising Rule") and proposed MFDA policy relating to IPC advertising (the "Advertising Policy"). The contents of the Initial Application addressed the subject of the seven criteria identified by the Commissions and reproduced as the CSA Criteria in the Initial Application.

The public comment period in respect of the Initial Application expired on January 24, 2003. A number of comments were received (which are reviewed and responded to below) concerning primarily whether an investor protection fund for MFDA Members were necessary at all or, if it were, whether the protection should be similar to that of the Canadian Investor Protection Fund ("CIPF") or part of CIPF. The Board of MFDA considered these comments and concluded, subject to certain conditions, that the prospect of MFDA participating in CIPF should be pursued. Accordingly, during the spring and summer of 2004 discussions were commenced with the board and management of CIPF. The nature and conclusions of such discussions are described in the revised Application referred to below, but it was determined that the Initial Application of MFDA IPC and MFDA would be amended and resubmitted.

On November 15, 2004, MFDA IPC and MFDA submitted a revised Application (the "Revised Application") to replace the Initial Application with the expectation that the relevant CSA Members would publish the Revised Application for comment. The Initial Application as amended by the Revised Application is referred to as the "Application". At the same time it was considered useful that a Summary of Public Comments and the Response of MFDA IPC and MFDA respecting the Initial Application should be published. However, in order to ensure that the responses of MFDA IPC and MFDA are current, the responses with respect to the Initial Application have been updated to reflect where appropriate amendments were made in the Revised Application. Accordingly, the responses set out below should be read together with the Initial Application as revised and replaced by the Application of November 15, 2004.

Seven comment letters were received during the public comment period:

1. CIBC Securities Inc., Royal Mutual Funds Inc., BMO Investments Inc., National Bank Securities Inc., Scotia Securities Inc., TD Investment Services Inc., HSBC Investment Funds (Canada) Inc. and LBC Financial Services Inc. by their counsel, Stikeman Elliott, (January 23, 2003) (*The commentators represented in this letter are collectively referred to in the summary of comments below as the "Bank-owned Dealers"*)
2. The Investment Funds Institute of Canada ("IFIC") (January 24, 2003).
3. BMO Mutual Funds (January 24, 2003).
4. Scotia Securities Inc. (January 24, 2003).
5. PFSL Investments Canada Ltd. (January 22, 2003).
6. Rice Capital Management Plus Inc. (December 10, 2002).
7. Royal Mutual Funds Inc. (January 24, 2003).

8. Federation of Independent Mutual Fund Dealers (the "Federation") (January 24, 2002).

Copies of comment submissions may be viewed at the office of the MFDA, 121 King Street West, Suite 1600, Toronto, Ontario by contacting Greg Ljubic, Corporate Secretary, (416) 943-5836.

The following is a summary of the comments received, together with the MFDA's responses to the Initial Application and updated to reflect the Application of November 15, 2004.

The Board of Directors of the IPC, the Board of Directors of the MFDA, MFDA staff and counsel have considered carefully all of the comment letters and observations made with respect to the Application. In addition, the IPC Chair and MFDA staff have had the opportunity to meet personally with many of the persons submitting comment letters. The responses set out below with respect to the various issues identified benefit from discussions with the persons making the comments. In addition, the IPC Chair and MFDA staff have been able to meet with representatives of Canadian Investor Protection Fund and also to discuss the relevant issues with representatives of the CSA Members including the OSC as the lead CSA Member for purposes of the application and co-ordinating comments as indicated above.

**1. General Comments**

**1.1 Need for MFDA IPC**

All the commentators expressed support for the general goal of consumer protection, but they also expressed concern with the need for the IPC, or various aspects of the IPC, as proposed.

The Bank owned Dealers and Rice Capital questioned whether a compensation fund for clients of mutual fund dealers was necessary. These commentators noted the relatively low risk business operations and activities of mutual fund dealers, in particular the fact that the majority of mutual fund assets are held in client name, and the historically low level of mutual fund dealer insolvencies and client losses. One commentator believed that further analysis of the mutual fund industry is necessary before establishing a compensation fund.

The Federation and PFSL supported MFDA IPC as an initiative but wished to have certain matters clarified and expressed concerns with aspects of the plan.

A general concern was expressed that the additional costs, duplication and inefficiencies related to MFDA IPC do not justify its creation. The extra costs are borne by the investing public and the protection provided is limited.

The Bank-owned Dealers pointed out that if it was determined that a compensation fund for mutual fund dealer customers were considered to be necessary, a number of alternatives to MFDA IPC were more appropriate (see Alternatives to MFDA IPC below.)

The Bank owned Dealers also observed that dealers in the United States who restrict their business to the distribution of mutual funds are not required to participate in a contingency fund, and consistency between Canadian and U.S. securities laws is important.

The view was also expressed that the establishment of MFDA IPC was not required to satisfy the terms and conditions of MFDA's recognition orders by the relevant CSA Members.

Rice Capital commented that a bigger concern than MFDA Member insolvency is the stability and financial worth of the mutual fund issuers and their management companies. In addition, the creation of MFDA itself and other risk-reducing developments including fiduciary bonds to cover fraud and misrepresentation may make IPC unnecessary. On this basis, Rice Capital considered that the only reason for IPC would be to enable the quick settlement of a customer's account in the event of problems. However, it would be better if a CompCorp model were followed under which all industry participants such as fund companies, dealers, managers and other sales agents agreed to pool together quickly to settle claims and thereby put mutual responsibility on all participants. Rice Capital was also concerned that client restitution by IPC may make criminal charges against deceitful salespersons less likely.

**MFDA Response**

**Initial Application**

*To the extent that commentators have suggested that it is not necessary that a compensation fund for clients of mutual fund dealers be established, IPC has confirmed with CSA Members its understanding that such a fund or similar protection plan is necessary. IPC and MFDA understand that many of the commentators including the Bank-owned Dealers understand and accept (although reluctantly) this premise.*

*Notwithstanding the foregoing assumption that a protection plan is required, commentators suggested that alternatives to the IPC ought to be considered. IPC agrees with this comment and alternatives to an MFDA IPC are discussed in the following section. IPC also accepts the observation that a number of the detailed aspects of the protection plan to be offered by IPC remain to be determined and that such details will be important for assessing the viability and efficiency of the Plan.*

*The MFDA and IPC acknowledge the proposition that customer protection in the event of an MFDA Member insolvency ought to be made available on the most efficient and cost-effective basis possible, subject to maintaining appropriate levels of public protection. Although customer protection can only be provided with some additional cost, MFDA and IPC believe the structure of IPC minimizes any duplication or inefficiencies in cost.*

*The fact that mutual fund dealers in the United States are not required to participate in a contingency fund may have some relevance to whether IPC is necessary but, as indicated above, IPC has made its application on the basis of its understanding that the CSA requires a protection fund. Similarly, the fact that the specific terms and conditions of MFDA's recognition orders do not mandate IPC is irrelevant for the same reason, although it may be observed that the recognition orders clearly contemplate that a protection fund will exist.*

*The comment directed to the need for ensuring the financial stability of mutual fund issuers and management companies has been raised in the past. IPC and MFDA would agree that any measures to reduce risk to consumers in the mutual fund industry that are available at reasonable cost are worthwhile to consider. However, the MFDA and IPC are only able to consider the role of mutual fund dealers, and mutual fund issuers and management companies are not members of MFDA. In addition, the model of CompCorp in the insurance industry as establishing a pool of product issuers, managers and distributors (dealers) was suggested as an objective. However, we do not believe that CompCorp pools the resources of any insurance industry participants other than life insurance companies and IPC is not aware of any other industries in which fully integrated protection is available.*

*Lastly, the comment on the effect of customer compensation in the criminal process is not, in the view of MFDA and IPC, supported by the experience in Canada or the United States. In the recent major insolvencies handled by CIPF (Osler, McConnell and Company, Essex Capital Management) successful criminal prosecutions have followed. (The cases of Rampart Securities and Thomson Kernaghan have not been completed.) There is generally the same experience in the United States where the principals of firms liquidated by SIPC are often prosecuted. Apart from the motives of customers, the compensation funds and the security industry itself have a great interest in encouraging prosecutions for deterrence and other reasons.*

## **Revised Application**

*No change.*

### **1.2 Alternatives to MFDA IPC**

The Bank-owned Dealers commented that better alternatives to the IPC need to be considered. In particular, the Bank-owned Dealers strongly supported the alternative of requiring the MFDA to join CIPF as a participating institution. The Bank-owned Dealers were of the view that the assessments would be substantially lower, the monetary and coverage protection to clients would be dramatically superior and there would be no new bureaucracy or cost structure created. It was also noted that in the event of a serious insolvency in the securities industry, there would be a greater number of participants to draw on, thus benefiting all participants.

The following alternatives were also suggested by the Bank-owned Dealers:

- Require those mutual fund dealers that hold assets in nominee name to obtain third party insolvency insurance, guarantees or other financial assurance from a credit worthy financial institution.
- Require mutual fund dealers to make insolvency protection available to clients upon request, at the electing client's cost.
- Do not provide insolvency protection at all and require clear notice to clients of the absence of contingency fund protection.
- Continue the Ontario contingency trust fund and equivalent schemes for mutual fund dealers in other provinces, with continued modest assessments for mutual fund dealers holding assets in client name based on their much lower risk profile.

## **MFDA Response**

### **Initial Application**

*A number of alternatives to a separate MFDA IPC plan were proposed. The strongly supported alternative of requiring MFDA to join Canadian Investor Protection Fund ("CIPF") is under review by MFDA and IPC and has been discussed directly with representatives of CIPF as well as the CSA Members. It should be noted this proposal was one of the original options identified by MFDA, CIPF and the industry committees formed to assist in the development of MFDA and it has had, accordingly, consideration before IPC's application. Although a combined plan was initially rejected for a variety of reasons, it was considered again in more detail immediately after the current IPC application was made in November 2002. There are a number of aspects to the MFDA joining CIPF and having, in effect, a single fund for the securities industry. It is often noted that the respective businesses of mutual fund dealers and investment dealers are quite different and, accordingly, the risks and costs of providing insolvency protection differ. The MFDA and IPC expect to pursue this alternative in the next few months but have already identified a number of significant considerations for MFDA Members and the public. In view of the universal observation that costs in the Canadian securities industry must be controlled, MFDA and IPC are attempting to assess the costs and benefits of the proposal to join CIPF. A paper dealing with this subject is in the process of being prepared at the request of a subcommittee of the MFDA Board which is reviewing the matter.*

*It was suggested that mutual fund dealers who hold assets in nominee name may be able to obtain insolvency insurance, guarantees or other financial assurances in the commercial markets in lieu of establishing a protection plan. The experience of representatives of IPC and others is that such insolvency protection is not readily available, if at all, in insurance markets and the proposal is not viable.*

*The suggestion that insolvency protection be available at the option and cost of clients of Members raises a number of regulatory implications. The ability of a client to assess whether insolvency protection is desirable or necessary is uncertain, but the drastic consequences if such protection is not available and client assets are lost would indicate that strong assurances that clients are able to assess such risks are important. MFDA and IPC are of the view that such assessment would be difficult for many clients. Coverage provided on an optional, on request basis, is likely to be expensive because the economies of establishing a larger fund will not be gained. In addition to the foregoing, the complications arising from the administration of such an arrangement, public disclosure and the administration of insolvency suggests that the proposal is not practical. In addition, the MFDA and IPC view the alternative of simply providing clear notice to clients of the absence of contingency fund protection as not addressing the public interest concern.*

*A further suggestion was made that the existing provincial contingency funds such as those that exist in British Columbia, Ontario and Nova Scotia be continued with possible adjustments in coverage, assessment and administration to better reflect the business of mutual fund dealers. MFDA and IPC are of the view that national protection is important and, as indicated, not all provinces have such protection plans. In addition, the existing plans are not uniform in application and are, by general recognition, somewhat archaic in their coverage limits and ability to participate in dealer insolvencies*

### **Revised Application**

*The Revised Application describes the extensive discussions and review with CIPF and the fact that those discussions are expected to continue following the establishment of IPC.*

## **2. IPC Application and Approval Process**

### **2.1 Lack of MFDA Member Input in Development of MFDA IPC**

The Bank-owned Dealers felt that MFDA Members have not had the opportunity to provide input into the Application or the structuring of the IPC. These commentators were of the view that the details of any proposed contingency fund that is mandated by the MFDA, as well as the proposed assessment methodology and any future changes thereto, must be approved in advance by MFDA Members on the basis that MFDA is to represent Members.

## **MFDA Response**

### **Initial Application**

*The whole development of MFDA including the proposed IPC has been premised on strong mutual fund dealer participation. The initial rules adopted for MFDA as part of its recognition in February 2001 were based on the input of industry committees including a committee that focused on capital and contingency fund requirements. In addition, the MFDA Board, which has directed the development of IPC over the past couple of years has strong representation from all MFDA Member businesses including, in particular, the Bank-owned Dealers and other independent dealers. Lastly, the purpose of publishing for comment the proposed model for MFDA IPC was to elicit comments from not only industry participants but regulators and the public. No*

significant aspect of IPC will be adopted without the approval of the MFDA and, in that regard, MFDA Members are well represented on the MFDA Board and in other capacities. This latter comment is particularly true in view of the proposed adoption of the recommendations of the MFDA Corporate Governance Committee whose February 2003 Report is available to the industry and the public.

### **Revised Application**

MFDA has been particularly conscious of the need to assess the effect of MFDA IPC on its various Members as well as the mutual fund distribution industry as a whole. As examples, in the review of joining CIPF, detailed and comprehensive questionnaires were sent to all Members (more than once to those who did not respond). In addition, the Bank-owned Dealers have continued to make representations to both the MFDA and CSA, and MFDA has participated in such discussions and will continue to do so.

## **2.2 Lack of Essential Information Needed to Properly Analyze the Application**

The Bank-owned Dealers stated that it is impossible to undertake a meaningful analysis of the MFDA IPC in the absence of any information regarding such matters as predicted risk of losses and the extent of historical losses. These commentators also expressed concern that this information was not made available to members of the MFDA Board in considering the IPC Application.

### **MFDA Response**

#### **Initial Application**

The observation by certain commentators including the Bank-owned Dealers on the lack of meaningful history and analysis with respect to risk and losses is acknowledged both by MFDA and IPC. However, the fact is that very little information of that kind is available. On the other hand, the persons involved in the development of IPC including its Chair (Don Leslie, former President of CIPF), industry members, MFDA staff and counsel have considerable experience in dealer insolvencies and are able to provide the best available assessment of risks, projected losses, etc. It is expected that as experience and knowledge is gained while IPC operates, its structure and operations could be modified.

#### **Revised Application**

No change. However, MFDA supports any efforts or information that would assist in more accurately identifying levels of risks and projected losses.

## **2.3 Lack of Analysis of Alternatives and their Costs and Benefits**

The Bank-owned Dealers expressed concern that the IPC Application did not contain a meaningful discussion and analysis of alternative methods of providing protection to clients of mutual fund dealers and accompanying cost-benefit analyses, particularly as they relate to the funding of MFDA IPC. It was noted that the adoption of rules by CSA Members such as the OSC requires consideration of such matters.

IFIC stated that its members have expressed concern due to the lack of a funding formula in the Application and noted that it is impossible to complete a cost benefit analysis of the IPC without a clear formula.

### **MFDA Response**

#### **Initial Application**

As indicated in the response to the foregoing section, it is acknowledged that limited data and objective cost / benefit analysis is available. In this regard, it may be noted that some sophisticated studies and risk / actuarial reviews have been conducted in the United States with respect to securities dealers but not mutual fund dealers. On the other hand, as indicated above, MFDA and IPC are currently preparing the best cost benefit analysis that can be considered which, although it will not be perfect, will be helpful and generally accurate. A number of discussions have been held with CIPF in this regard as well. This comment extends to the express desire for a clear funding formula. As described in the Application, the MFDA and IPC believe that funding on the basis of assets under administration is appropriate at this stage in the development of IPC and that the projections for the target size of the IPC fund are reasonable in the circumstances. As explained in section 5 of these Responses, the intention is to begin with a relatively small size fund and consider on an annual basis whether and how the fund should be increased as experience is gained.

## Revised Application

*No change. Reference is made to the discussions with CIPF and the intention of MFDA and MFDA IPC to review on a periodic basis all aspects of IPC including fund size, assessment made and coverage.*

### 2.4 Concerns Regarding the Legal Basis under which the IPC proposes to be Approved and Operate

The Bank-owned Dealers indicated that there are concerns as to the legal basis under which the IPC proposes to be approved and operate. They identified these concerns as arising from three separate factors that can be summarized as follows:

#### 2.4.1 Securities

The OSC is proposing to approve the IPC as a contingency fund under section 110(1) of the Regulations. However, section 110(1) of the Regulations relates to the approval of a fund, not a person. The fund is not intended to be a legal entity itself, but to be established by legal entity. Therefore the IPC, as a person would not appear to qualify. In addition, securities legislation in Ontario, British Columbia and Nova Scotia appears to explicitly limit approval to a fund established by the IDA or a recognized stock exchange. If a contingency fund is to be mandated under these provisions, the jurisdiction seems at best to be limited to requiring Members to participate in the existing CIPF.

## MFDA Response

### Initial Application

*The MFDA and IPC have discussed with the relevant CSA Members the legal basis on which IPC could be recognized or approved as a fund for the purposes of applicable securities legislation. The MFDA, IPC and members of the CSA are satisfied that the relevant statutory provisions refer to a fund of the kind proposed in the Application.*

### Revised Application

*No Change.*

#### 2.4.2 Insurance

It appears that the IPC will be engaged in the business of insurance without complying with applicable insurance laws. The IPC appears to rely on the principle that insurance laws are not implicated if payments to clients are "discretionary". However, the language of the Application materials, in particular references to "claims", "coverage" and "protection" and references to facilitating clients' ability to sue the Corporation and the terms and conditions of the proposed approval order (e.g. section 4) suggest that this in fact not the case. Participation by MFDA Members in the IPC could expose them to potential liability under insurance laws.

## MFDA Response

### Initial Application

*The MFDA and IPC are not certain of the intent of the comment that IPC may be engaged in the business of insurance. If the intent is to require IPC to qualify as an insurer and to be regulated by applicable insurance regulators at both the federal Canadian and provincial levels, the costs of establishment and operation of IPC will be very much higher than proposed. This intent would appear to be generally inconsistent with the observations by MFDA Members including the Bank-owned Dealers. As a technical legal matter it is proposed that IPC would constitute a fund offering discretionary coverage, but within reasonably defined parameters, and it would not, therefore, constitute insurance.*

### Revised Application

*No Change.*

#### 2.4.3 Extra-territorial

It is unclear how the IPC will operate from an extra-territoriality perspective, as it appears that clients in other locations, both in and outside Canada, would be covered. This creates concerns about jurisdiction, since it is unclear on what basis, for example, the OSC indirectly compels mutual fund dealers to provide coverage for clients in Prince Edward Island or Quebec. It may also lead to the MFDA and the MFDA IPC having effective powers over mutual fund dealers in jurisdictions where it is not recognized. Finally, it would compel mutual fund dealers to pay for duplicative coverage, since other jurisdictions often have their own contingency fund or similar requirements. IFIC also requested clarification regarding IPC coverage to clients of mutual

fund dealers in jurisdictions where the MFDA is not recognized. The Federation has sought clarification as to the co-ordination of the timing of coverage by IPC of clients in Quebec and the entering into of a mutual reliance arrangement between MFDA and Quebec regulators.

## **MFDA Response**

### **Initial Application**

*The matter of extra-territorial operations of IPC do not appear to be of a substantive concern. CIPF offers coverage to customers of its members wherever they are located in the world. The requirement to belong to IPC would be mandated by MFDA itself and MFDA can impose whatever reasonable conditions of membership that it wishes. Similarly, IPC would be able to define limits to its coverage by jurisdiction and, for instance, in jurisdictions where MFDA is not recognized, it may choose not to provide coverage. However, neither MFDA nor IPC are satisfied that such a course of action is appropriate. The matter of Quebec, where MFDA is not presently recognized, is a separate matter because MFDA and the Bureau des services financiers as well as the Chambre de la sécurité financière have entered into a co-operative regulatory agreement which is pending approval by appropriate regulatory and governmental authorities.*

### **Revised Application**

*Since the Initial Application, the Autorité des marchés financiers has been established and taken over the functions of the former BSF and FISF (the Quebec protection fund). The Autorité has now approved the co-operative regulatory agreement which permits MFDA satisfactory authority with respect to its Members' affairs in Quebec regarding prudential regulation. IPC will not initially provide coverage for customers with accounts in Quebec at MFDA Members.*

## **3. Corporate Governance**

The Bank-owned Dealers felt that the governance structure of the MFDA IPC was deficient in that it was not appointed by MFDA Members but pre-selected. They noted that the IPC directors would also be the sole members and suggested that this would have the effect of limiting MFDA member input into the IPC's affairs. These commentators were also concerned that they will have no representation on the IPC Board, but will be required to pay the majority of the assessments. They suggested that this is inconsistent with the CSA's criterion that the MFDA IPC should ensure " a proper balance between the differing interests of the MFDA Members participating in the MFDA IPC." The Bank-owned Dealers were of the view that this balance must be put into place prior to the approval of the IPC to enable the governance process to function properly.

## **MFDA Response**

### **Initial Application**

*It is considered necessary that the operations of each of MFDA and IPC will have to be closely co-ordinated. At the outset it is proposed that MFDA would be responsible for the selection of IPC directors within the parameters adopted including the fact that the majority of the directors would be public and not industry representatives. The fact that this selection process would be made by MFDA under its proposed governance structure which is intended to be fully representative of the mutual fund industry and the public will ensure integrity in this process. In fact, the diversity of members is intended to be better represented through the new proposed governance structure for MFDA. A governance structure that bases representation on the amount of assessments paid is not considered fair or appropriate in the mutual fund industry.*

### **Revised Application**

*The new governance structure of the MFDA was implemented in December 2003 and ensures that its Board is properly representative of its Members' diversity.*

## **4. Coverage**

The Bank-owned Dealers commented that the primary purpose of a contingency fund appears to have been overlooked in the Application because MFDA IPC will not provide coverage to assets of Members held in client name.

The Federation commented that RESP accounts should be treated as separate or combined according to whether they have the same beneficiary, not the same trustee.

PFSL commented that IPC should act quickly to reimburse client losses in the event of an insolvency and, if it did, it should receive preferential treatment in the remaining assets of the insolvent Member's estate.

## MFDA Response

### Initial Application

*The observation that assets of a customer purchased through an MFDA Member but held in client name will not be covered by IPC is correct. On the other hand, cash related to such purchases may be in the possession of the Member and the opportunity for Members and Approved Persons to deal with Member assets, even if they are held in client name, is relatively high. The common practice of Approved Persons holding powers of attorney from clients creates the functional equivalent of nominee holding for client name securities subject to the power of attorney. Furthermore, one of the purposes of MFDA IPC is to enhance the general integrity and confidence in the mutual fund distribution industry and all participants should share the cost.*

*The rationale for treating RESP accounts as being separate according to the trustee is that the trustee is always primarily responsible for the assets and is, in fact, the legal customer for the purposes of coverage. Accounts held in such manner are held in a separate capacity and circumstance and should be considered separate accounts.*

*In the event of an insolvency of a Member Part XII of the Bankruptcy and Insolvency Act (which relates to securities dealers and mutual fund dealers and came into force in 1997) does confer preferential treatment to customers of such dealers. The ability of IPC to act quickly invariably reduces total losses to customers and will, as a result, increase assets available to other creditors.*

### Revised Application

*No Change. The Revised Application reflects that coverage is to extend to all cash, securities and other property held by an insolvent Member.*

## 5. Fund Size

Two commentators questioned whether the proposed size of the fund is appropriate. One of these commentators noted that there is no discussion in the IPC Application as to how the predicted risk of loss, one of the factors considered in establishing the size of the fund, was determined. This commentator expressed concern that the risk of loss prediction may have been based on CIPF's experience, which could not be reasonably applied to mutual fund dealers given that CIPF members operate almost exclusively in nominee name. The other commentator recommended that the level of funding be reviewed at regular intervals, considering experience and potential for loss, and that the funding requirements be kept to what is necessary.

## MFDA Response

### Initial Application

*As indicated above, there is no accurate, objective data or information with which to project the appropriate size of the fund of assets to be maintained by IPC. However, anecdotal evidence and experience is available and it is predicted that a fund of \$30 million within five years would be a reasonable and adequate initial target. The CIPF experience was reviewed and it is of some help, but it was not considered by MFDA or IPC to be determinative of the needs and experience of the mutual fund industry. The commentator indicated that the risk of loss of mutual fund dealers and securities dealers is quite different (with which MFDA and IPC agree) but it may be noted that the largest loss suffered by CIPF to date was approximately \$35 million before insurance and other recoveries. In any event, the expectation is that the level of funding would be under annual review and will be changed as experience is gained. In addition, the prefunding principle of IPC does not preclude future assessments if, in the unlikely event, any individual or combined member losses exceeded funds available. In effect, the credit of all mutual fund dealers is at risk because all dealers are subject to assessment for any deficiency, and in that sense fund size is somewhat academic.*

### Revised Application

*The initial fund size is to be increased to \$30 million consisting of a combination of cash and a line of credit from an institutional lender. MFDA IPC has secured a commitment (subject to normal terms and conditions, all of which are expected to be satisfied) for \$30 million from a Canadian chartered bank.*

## 6. Funding and Assessments

### 6.1 General Comments

Several commentators expressed general concern over the cost of the IPC and the introduction of another fee for mutual fund dealers in light of the current state of the mutual fund industry. Commentators noted the decline in overall dealer profitability and expressed the view that every effort should be made to keep the cost of funding and administering the IPC as low as possible.



IFIC believes that the IPC should establish a funding formula that explicitly states how assessments will be made and how much money mutual fund dealers will be required to pay. The lack of a funding formula also precludes a cost benefit analysis of the IPC.

The Federation sought clarification as to how money in any existing provincial contingency funds will be handled and whether it will be incorporated into IPC or returned to dealers. The amount of money in such funds was also asked to be reported on.

## **MFDA Response**

### **Initial Application**

*As indicated in the Responses to some of the comments that have been made in respect of the Application, both the MFDA and IPC are sensitive to excessive and/or duplicative costs in mutual fund dealer regulation, particularly because of the financial pressure that many securities and mutual fund dealers are currently experiencing. Both IPC and MFDA intend to minimize the cost of funding and administering the IPC to the extent possible while still maintaining appropriate regulatory safeguards in the public interest.*

*The application proposes a specific funding formula including the basis of how assessments will be made and collected. In particular, the application states that the initial funding formula will be \$30 per million of AUA to provide approximately \$5 million and thereafter \$30 per million of AUA (payable at \$7.50 per quarter) for five years, subject to annual review. One of the reasons that the proposed funding formula is based on assets under administration is that such information is collected and available to members in respect of the calculation of MFDA's own fees. The matter of whether assets under administration is the most appropriate basis for a funding formula has been the subject of considerable debate and consideration. However it is the view of IPC and MFDA that at least in the initial stages of the development of IPC that that basis for funding formula is the most appropriate. It may be that as experience is obtained with IPC that other funding formula could be considered.*

*The CSA Members in provinces where there are existing contingency funds are reviewing the future of such funds.*

### **Revised Application**

*The fund size, source of funds and assessment approach have been amended in the Revised Application.*

## **6.2 Assessment Methodology**

### **6.2.1 Assessments on Client Name Assets**

The Bank-owned Dealers noted that since the IPC does not propose to cover client name assets, there will be little or no protection afforded to their clients who hold all their mutual fund assets in client-name. These commentators believed that the proposed assessment methodology based on assets under administration ("AUA") would be inequitable and unreasonable since they will be required to pay substantial assessments, yet neither they nor their clients will derive much benefit from the IPC because their client name assets are not covered. It was noted that the CSA criteria included the principle that assessments be equitably allocated and set by a process that is fair and reasonable. In addition, to the extent that Members perceive that MFDA IPC assessments are too costly, they may leave the MFDA and become investment dealers, ICPMs or other category registrants.

IFIC also commented that it is not reasonable to require dealers to pay assessments for client name assets that will not be covered by the IPC. IFIC stated that if all mutual fund assets are assessed whether covered or not, the IPC will be incongruent with the principles of CIPF, which does not levy assessments on client name assets. IFIC noted that this would also be inconsistent with section 5.1 of the Application, which states that the IPC's coverage principles will be similar in kind to those of the CIPF.

The Federation commented that the funding formula does not distinguish between nominee and client name assets; and that the assessments for IPC should be based on nominee name held assets which would be consistent with the principles of CIPF.

## **MFDA Response**

### **Initial Application**

*The rationale for an assessment methodology based on AUA is explained in the application and the Responses to comments above. As indicated, client name business is not entirely risk free to customers as cash and assets (particularly securities subject to dealer or Approved Person powers of attorney) can be at risk in a dealer insolvency. The broader principle is that it is responsibility and in the interest of all distributors of mutual fund products to ensure that the investing public has confidence in their business and that protection is afforded to all customers. The benefits of a strong market with few barriers other than*

*appropriate regulatory standards is shared by all dealers of whatever size and the investing public as well. In the circumstances, MFDA and IPC believe that the criteria of the CSA Members that assessments be equitably allocated and set by process that is fair and reasonable is satisfied. However, as the IPC grows and experience is obtained in the changing mutual fund business, other methods of assessment may be considered.*

*CIPF does not levy assessments on client name assets or, for that matter, any other assets. CIPF assessments are based on all revenues of members which include commissions in respect of client name business. In addition, the coverage principles to be adopted by IPC are generally similar to those of CIPF except that the range of products is to be limited by IPC.*

#### **Revised Application**

*MFDA and IPC will review at least annually the basis on which IPC assessments are made.*

#### **6.2.2 Non-Risk Weighted Methodology**

The Bank-owned Dealers and PFSL Investments Canada Ltd. ("PFSL") commented that the IPC assessment methodology does not allocate costs on the basis of risk. The Bank-owned Dealers indicated that the IPC assessment methodology should address the higher risks associated with such activities as holding assets in nominee form and the sale of prospectus-exempt products such as limited partnerships and hedge funds. Risk factors should include others than size. It was noted that other consumer protection funds such as CIPF, the Deposit Insurance Corporation of Ontario and the Canada Deposit Insurance Corporation employ a risk-weighted methodology.

The Bank-owned Dealers also observed the risk arising from losses of cash held by a Member will be limited because cash floats are typically quite small and client funds are promptly applied to the purchase of securities. Any cash is held in trust. As a separate but related point, it was noted that members of the IDA are not required to hold client funds in trust and, if MFDA IPC is created, the *quid pro quo*, and as a matter of fairness on equal access to capital, would be equivalent treatment for mutual fund dealers. This would require changes to provincial legislation and regulations.

In a separate submission, Scotia Securities Inc. ("Scotia") expressed concern that the IPC is based on the premise that the overwhelming proportion of products sold by MFDA Members will be mutual fund securities despite the fact that the Application states that there is little experience or empirical evidence regarding the extent of non-mutual fund business carried out by MFDA Members or the risk attached to such non-mutual fund business. Scotia stated that if a compensation fund is to be approved for MFDA Members, serious consideration should be given to restricting their securities activities to prospectus qualified open-ended mutual funds and debt instruments issued or guaranteed by government or financial institutions.

PFSL commented that the IPC AUA assessment methodology does not consider factors that would reduce the risk of insolvency such as high capitalization and strong internal controls. PFSL suggested that the MFDA, through its audit process, could assess each Member on an individual basis for the potential risk of loss to clients. Those Members assessed as having a low potential risk of loss could be given a rate reduction while those assessed as having higher risk could be assessed at a higher rate.

#### **MFDA Response**

##### **Initial Application**

*The ability of MFDA and IPC to adopt a risk weighted methodology for assessments at the initial stages of IPC's development is not practical. In the first place, the wide range of business structures, capitalization, business activities and other factors present in MFDA members make it difficult to fairly weigh and assign risk. It is noted that CIPF's assessment structure is not risk based, with the minor exception of special assessments for regulatory capital non-compliance. In the second place, it is expected that the experience of IPC will be similar to that of CIPF in that most if not all potential losses will be as a result of or influenced by fraud. It is difficult in any kind of organization to assign appropriate risk weightings to the possibility of fraud. The MFDA and IPC have reviewed other consumer protection funds that cover fraud. A good example is the kind of compensation funds operated by provincial law societies in respect of lawyer fraud. The Law Society of Upper Canada, for instance, assesses its members a flat amount (\$379 in 2001) per lawyer on the basis that it is not possible to predict where or when fraud in an organization such as a law firm – or securities or mutual fund dealer – may occur.*

*The fact that a high proportion of the business of mutual fund dealers is in prospectus qualified mutual fund products or other "safe" government and financial institution products does not necessarily reduce risk to a dealer or its customers. The product may maintain its value in an insolvency but the insolvency risk is still present. Moreover, fraud usually involves dealings in the most liquid assets that a customer has (i.e. cash, freely transferable government debt and money market funds).*

##### **Revised Application**

*MFDA and IPC will review at least annually the basis on which IPC assessments are made.*

## 7. Advertising Related to IPC Coverage

The Bank-owned Dealers noted that the proposed amendments to MFDA Rule 2.7, which mandates advertising of the coverage provided by the MFDA IPC, could potentially be confusing and misleading to their clients since client name assets would not be covered. This concern was repeated in separate letters submitted by Royal Mutual Funds Inc. ("RMFI"), Scotia Securities Inc. and BMO Mutual Funds. RMFI proposed that client name assets be excluded from all aspects of the MFDA IPC and that appropriate disclosure language be drafted to clients as to the absence of contingency fund protection. In the alternative, RMFI suggested that coverage be extended to all assets held in client name, eliminating the need for disclosure explaining the differences in coverage dependent on holding status.

### MFDA Response

#### Initial Application

*The intention of the advertising requirements is to generally advise customers as to the existence of IPC coverage and the MFDA IPC official explanatory statement is specific that it is property held by the member that is covered. Customers should be advised, or be able to find out by inquiry, that if assets held by a member cannot be accounted for in the event of an insolvency as a result of the invasion of the account (to use SIPC terminology) compensation within the stated limits will be available. MFDA and IPC, as well as the relevant CSA Members, are conscious that the mandatory advertising be clear to customers and the experience during the initial period of IPC's operation can be monitored and any adjustments made to the requirements, if necessary.*

#### Revised Application

*The Revised Application refers to all cash, securities and other property held by a Member for a client as being covered by IPC, subject to eligibility and coverage limits. This approach minimizes client confusion as to what assets are covered and, correspondingly, the advertising requirements in MFDA Rule 2.7 can be simplified.*