

March 8, 2012

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Dear Sirs/Mesdames:

RE: Consultation on Compensation of Québec Consumers of Financial Products and Services

We are writing in respect of the Consultation Paper issued by the Autorité des marchés financiers (AMF) in November, 2011 regarding the Compensation of Québec Consumers of Financial Products and Services. Investment Planning Counsel Inc. (IPC), which is a subsidiary of IGM Financial Inc., is a diversified financial services company and a manager and distributor of mutual funds, with \$17 billion in assets under management as of February 29, 2012, of which approximately \$275 million is held by residents of Québec.

IPC has a team of 860 advisors with approximately 27 advisors serving Quebec residents.

The core of our business is providing comprehensive financial planning to people across Canada to help them reach their goals, particularly when it comes to their retirement. IPC is very concerned with the devastating consequences suffered by certain victims of financial fraud and, accordingly, is greatly interested in the AMF's Consultation Process to examine the effectiveness of present compensation systems and ways to improve them.

We have a number of general comments relating to the Consultation Paper as well as specific responses to the questions set forth in it, as follows:

A. General Comments

1. Enhancements to Existing Regime

The current investor protection regime in Québec is a combination of a number of separate elements that has certain deficiencies. The discussion that the Consultation Paper engenders provides an opportunity to examine the overall

structure of this regime in Québec with a view to identifying gaps and possible solutions to this issue. In our opinion the following are the major areas that should be addressed as part of the outcome of this review:

- *Insolvency contingency fund*- Québec is unique in Canada in that its consumers who deal with mutual fund dealers are not protected by a contingency fund that will reimburse losses as a result of the insolvency of their dealer. This is a major gap in the protection provided to investors and to close it we would suggest that extending the Investor Protection Fund that protects members of the Mutual Fund Dealers Association of Canada (MFDA) elsewhere in Canada to Québec as a possible solution.
- *Fidelity insurance*- the current investor protection scheme in place in Québec protects consumers against fraud committed by an advisor of a firm through the Financial Services Compensation Fund administered by the AMF. In our view a more effective way to protect against this risk is to require that all registered dealers maintain fidelity insurance in a prescribed amount, coupled with a rule that the capital that firms maintain include the amount of any deductible payable under those policies. Not only would replacing the existing fund with fidelity insurance be a more effective way to address the risk of fraud, it is consistent with the principle that firms should be responsible for addressing their own problems. These requirements are already in place under the rules governing members of the Investment Industry Regulatory Organization of Canada (IIROC) and the MFDA. Currently the rules in place in Québec do not require that registered dealers maintain this insurance, although most large firms do so voluntarily. All dealers should be required to have fidelity insurance to close this gap.
- *Enhanced oversight*- experience has shown that effective oversight of registered firms is the first line of defense against their financial failure and resulting losses to their clients. This is accomplished by a combination of regular financial reporting and periodic audits of registrant firms. Both IIROC and the MFDA have well established and robust rules coupled with a risk based audit program to further these goals. However, the MFDA has not been recognized as a Self Regulatory Organization (SRO) in Québec, meaning that the AMF has primary responsibility for supervising this sector.

The comprehensive solution to this problem is to recognize the MFDA as an SRO in Québec, similar to the existing situation where investment dealers are supervised by IIROC, which is recognized as an SRO in Québec. Mutual fund dealers in Québec are currently in a curious position in that if they operate in other jurisdictions they are overseen by the MFDA in the 12 other jurisdictions in Canada. If, on the other hand, they operate only in Québec

they are not supervised by an SRO (although their advisors are regulated by the *Chambre de la sécurité financière*).

The SRO model has a number of proven advantages: improved compliance performance of members as a result of inspections, clearly articulated standards and expectations and the mutual benefits that accrue to both the regulator and the regulated firm as a result of the ongoing interactions they have and the interactive process of policy development. This disconnect – the lack of MFDA recognition – with the rest of Canada potentially puts Québec investors at a disadvantage in that the AMF has sole responsibility for the oversight of mutual fund dealers in Québec instead of sharing the role with an SRO and the specialized industry knowledge that it brings.

Further the comprehensive rules that the MFDA has developed do not apply in Québec, meaning requirements are not harmonized across the country – a problem for dealers – and raising the potential for a gap in the rules that apply. The AMF has recognized this as an issue in previous consultations it has carried out (most recently in 2010) during which it suggested that adopting the MFDA's rules may be worthwhile. We would recommend strongly that consideration be given to recognizing the MFDA as an SRO in Québec, paralleling the existing with IIROC, or adopting the MFDA's rules.

2. *Enhanced Consumer Education and Professional Advice*

A knowledgeable consumer is a less vulnerable consumer. Clients clearly have a responsibility carry out a certain level of due diligence, appropriate to their sophistication and circumstances, when presented with an investment opportunity. Enhanced investor education can better equip them with the ability to meet this obligation, to ask the right questions and maintain an appropriate degree of skepticism. One of the best ways of doing this is one that is not always recognized: the use of a registered advisor. While enhanced consumer education is not a cure all, it is an important element of any investor protection regime.

3. *Tough Sanctions*

Even a strong regulatory system will have people who operate outside its scope and the protections that it provides to consumers. It is important that when these situations arise that these unregistered individuals are dealt with firmly, through a speedy process that results in tough penalties. The message to the public must be that fraudulent conduct will not be tolerated.

B. Specific Questions

The following is our response to the specific questions raised in the Consultation Paper. For ease of reference we have set out each of these before our comments:

1. Based on your perception of the Québec system, should we rethink the balance between fraud prevention and victim compensation measures?

Yes. Fraud prevention should be the primary focus in that it is the best way to prevent client losses that trigger claims against victim compensation measures. This has many elements, including enhanced oversight of registrants, with an expanded, risk based, regular inspection program, and increased education for consumers. Recently the Canadian Securities Administrators adopted the Registration Reform Rules – National Instrument 31-103 – that have implemented many of these elements, including the new requirement that investment fund managers be registered, which are just now starting to bear fruit.

2. Since financial resources are limited, which solution should be given priority: bolstering fraud prevention measures or enhancing the compensation plan?

The experience of other industry compensation funds, such as the Canadian Investor Protection Fund (CIPF) and the MFDA Investors Protection Fund (MFDA IPC), has shown that preventative measures are the most cost effective way to reduce claims. The SROs associated with these funds have adopted comprehensive and risk based rules in key areas (eg. capital, regular financial reporting) designed to ensure firms can meet their obligations coupled with strong financial compliance oversight programs to identify problem members early to prevent losses to the public. Firms that fall short of regulatory requirements should be subject to sanctions that are appropriate to the nature of the failure.

3. Do consumers have a certain responsibility to avoid financial fraud?

Yes. Consumers clearly have to carry out a reasonable level of diligence in dealing with financial firms and advisers, which must start with the principle that any contingency fund will only apply to registered firms and advisers. If clients believe they have a right to compensation without having an obligation to assess the reasonableness of the products and advice they are being offered, an element of moral hazard is introduced into the system. For example, it may prompt consumers to invest in products with an unreasonably high promised rate of return without their having to assess in inherent risks and warning signs such products entail.

4. How much importance should the compensation mechanisms in Québec place on the accountability of consumers and representatives?

There needs to be a balance between consumers and representatives regarding accountability. Representatives have ethical standards that they must meet including acting in the best interests of clients and, among other things, not defrauding them. At the same time, consumers must exercise a level of diligence appropriate in light of the facts of a particular situation. Further, in assessing whether consumers bear some of the blame for their loss in specific situations, their conduct must be examined to determine whether they were negligent. If they were, any compensation payable to them needs to be adjusted to take into account their degree of responsibility, based on the concept of contributory negligence. This reflects the fact that not all investors are the same, with some being more sophisticated than others (generally speaking a lower degree of diligence may be expected from individuals with a particular vulnerability, for example, than from others).

5. Should a consumer who knowingly makes an illegal investment lose the right to be compensated in the event of fraud?

Yes. The general legal principle that an individual should not profit as a result of his or her illegal act should apply here. Put another way, agreeing to becoming involved in an illegal investment falls short of the standards expected of a reasonable investor and this should disqualify him or her from receiving compensation.

6. Should the fundamental objective of compensation for victims of financial fraud in Québec be to enable victims:

- a) to recover a level of resources needed to avoid abject poverty?
- b) to recover the sums lost up to the very last dollar, regardless of the impact on costs, on the competitiveness of the industry or on the issue of accountability?

The difficulty here is in the way the question is framed since it is focused on the nature of a specific claimant. Any compensation fund must define the circumstances in which it will provide compensation and the maximum amounts it will pay. The amount paid to a particular consumer should not be based on their individual financial circumstances, although this may come into play indirectly in determining whether they met the standards expected of them in respect of the specific investment. Instead the limits of compensation should be clearly defined in the documents governing the fund in terms of maximum limits, covered assets and the like. At the same time, the terms and conditions governing the compensation fund should balance the need for appropriate

compensation limits against the long term viability of the fund from an industry perspective.

7. Should the current maximum compensation of \$200,000 be revised upwards or downwards?

The appropriate compensation limits should be determined after reviewing the levels of protection, in terms of both dollar limits and covered assets, provided by other options in Canada and elsewhere and any insurance carried by the representative and/or the firm, while taking into account all relevant factors.

8. Should the uniqueness of Québec's compensation scheme be maintained? Would it be better to choose a system that more closely reflects practices outside Québec?

As set out in more detail in the general comments we have provided, the unique approach taken in Québec may not serve consumers in the province well. A more appropriate and comprehensive approach should include the following elements in place of the existing compensation fund: (i) more emphasis on prevention through an enhanced set of rules regarding capital and other issues and a program of rigorous, regular audits of registrants using a risk based approach; (ii) an insolvency fund in the nature of CIPF or the MFDA IPC; (iii) mandatory fidelity insurance coverage for all registrants to provide protection in the nature of that currently provide by the current compensation scheme. These steps, which would align the situation in Québec more closely with that elsewhere in Canada, is consistent with a number of recent initiatives adopted by the AMF, including the passport system and Registration Reform.

9. Would the adoption of a compensation system based on the insolvency of firms be a way to provide more protection to consumers? Would it create a better balance between the extent of coverage and costs?

Yes. An insolvency based compensation fund is the key element of investor protection schemes across North America outside of Québec. As noted earlier, implementing this would close a significant gap in the current investor protection regime in Québec.

10. Should the current governance of the Fund, which is administered as a separate patrimony by the AMF, be re-examined?

The current compensation fund in Québec is unique in being run by the regulator, the AMF. Other compensation funds, such as CIPF and the MFDA IPC in Canada, are run by a board of directors that is separate from the regulators, but which report to them on an ongoing basis. In short, the AMF's role should be to oversee the operation of the fund, as opposed to actually running it.

11. If so, who would be better placed than the AMF to assume the fiduciary duty? Fund contributors? Consumers? Would there be a conflict of interest if contributors or consumers ruled on claims?

The fund should be run by an independent body with a governance structure that incorporates input from the industry, self regulatory organizations, securities regulators and the public, although always under the overall oversight of the AMF. Claims should be adjudicated in a fair and consistent way in accordance with clear criteria governing the administration of the fund by individuals exercising independent judgment.

12. Would a court or an arbitrator limit the possibility of conflicts? Would increased independence adversely affect the simplicity of the compensation process for consumers?

An arbitration mechanism may be a useful element to include in the overall investor protection scheme. Reconstituting the compensation fund as an independent body should not have an adverse effect on the compensation process for consumers since the key is adopting appropriate procedures to review, process and pay claims on a timely basis. The fact that CIPF and the MFDA IPC have been able to do so highlights the fact that this should not be a problem.

13. Given that fraud can be multidisciplinary or simultaneously involve various types of financial products and services, should we re-examine the integrated approach currently used in Québec, in other words, a single Compensation Fund to cover several types of financial services?

The fund should cover firms that deal directly with the public. For the most part this would include the distribution arm of the financial services sector, as opposed to manufacturers, since that is where the primary risk lies. The latter should come within the scope of the fund only to the extent they deal directly with the public. Further, regardless as to which firms are covered, costs must be allocated among participants in a fair way based on the claims paid out by the fund among the various sectors. An additional crucial consideration is that the fund should not cover individuals or firms that are unregistered. Finally, it is important that the fee structure supporting the fund be fair and equitable and not count the same assets twice. As a result, any fees payable in respect of these assets should either be assessed against at the distributor level or the manager level, but not both.

14. Should the conduct covered include actions outside the limits permitted by the representative's certificate or registration? For example, if a representative in insurance

of persons (life and health) commits mutual fund fraud, should his actions be covered by the Compensation Fund?

No. Activities carried out by a registrant that are outside of the scope of his or her licence should not be covered by the fund.

15. Should the Compensation Fund coverage be extended to all entities registered with the AMF, including investment dealers and fund managers?

Compensation Fund coverage should only be extended to firms that deal directly with the public. As a result, only fund managers who have direct relationships with the public should be included and in that case only that portion of their business should come within the scope of the Compensation Fund. Again, premiums should be assessed based on the risks presented by the various sectors that are covered by the Fund and, as noted above, the same assets should not be assessed twice in determining the fees that are required to be paid.

16. Should the Compensation Fund coverage be limited to conduct currently covered, i.e. fraud, fraudulent tactics and embezzlement?

As noted in our general comments above, the fund should be reconstituted (or replaced by having the MFDA IPC fund cover Québec firms) as one that protects consumers in the event of an insolvency of the firm with which they deal.

17. Should we instead expand the coverage to include gross negligence, errors, omissions and any other failure?

No. The fund should be limited to protecting consumers in the event of a firm's insolvency. Negligence should be addressed through a more efficient adjudication system that includes an ombudsman service to provide mediation and perhaps a new arbitration mechanism, as is currently the case with IIROC. Errors and omission issues should be addressed through mandatory insurance on the part of firms and their representatives. Extending the fund to cover gross negligence, etc. in our view raises significant other issues including the compensation fund acting as an 'insurance' policy and potentially conflicting with, and possibly prejudicing, coverage under any policy of insurance carried by the representative or the firm.

18. What would the implications be? For example, would there be a risk of overlapping with other compensation programs or professional liability plans?

There is just such a risk of overlap and duplication. As a result, care will have to be taken in developing a system that minimizes these potential issues.

19. Considering the extent of the Fund coverage, its costs and economic consequences, as well as its potential effect on the conduct of consumers and representatives, is the current balance between these elements appropriate? If not, in which direction should the balance be shifted and what are the implications of doing so?

As commented earlier, an improved allocation of responsibility between consumers and representatives that recognizes the level of diligence a reasonable client should apply is an important area to address. An important part of this is a program of enhanced investor education to ensure that consumers are better equipped to make investment decisions that are appropriate to their circumstances and, as part of this, to avoid fraudulent or questionable financial products.

20. Should we implement cost containment measures and increase the accountability of consumers and representatives? If so, what should these measures be and why? What are the pros and cons of such measures? What outcomes should we strive to achieve or avoid?

Yes. A combination of measures is required, including restructuring the investor protection framework along the lines we have recommended and enhancing investor education to make the public more aware of possible frauds and the due diligence responsibilities that they have. This must be coupled with an enhanced and comprehensive oversight system for registrants, including a rigorous program of regular inspections using a risk based approach that holds representatives accountable to the extent that they are responsible for an individual's loss.

21. To what extent should the Compensation Fund adopt capitalization measures to ensure its survival and limit the variability of contribution rates in the event of a major fraud?

Once a decision is reached as to exactly what the fund should cover, an analysis should be conducted as to what level of capitalization it requires and what limits should apply. This may be comprised of a combination of one or more of cash, insurance policies, lines of credit, disgorgement proceeds and guarantees, but a final determination should be based a study as to what level of protection should be provided and how quickly it should be reached.

We appreciate having this opportunity to share our views regarding the proposed Rules and Guidelines and would be pleased to discuss any of these concerns with you at your convenience. If you would like to do so, please contact John Novachis at John.Novachis@ipcc.ca.

Yours truly,

INVESTMENT PLANNING COUNSEL INC.

A handwritten signature in black ink, appearing to read 'John Novachis', is written over the printed name and title.

John Novachis
Executive Vice-President, Corporate Development