THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

Protection of Mutual Fund Investments

Today, mutual fund companies manage over half a trillion dollars for Canadian investors. There are many reasons for the continued popularity of mutual funds, including the extensive regulatory framework and contingency funds that are in place to safeguard investments.

There is no protection against the rise and fall in value of an investment because of market fluctuations, but there are many ways to reduce risk. We discuss risk in another information sheet.

Are mutual funds covered by the Canada Deposit Insurance Corporation (CDIC)?

No. CDIC insures money deposited into a financial institution. Mutual funds may be purchased at financial institutions but are not deposits and therefore are not covered under CDIC.

When you invest in securities through a pooled investment like a mutual fund, you actually own a portion of the fund's investments. Unlike a bank deposit, which is essentially a loan to the bank for which you are paid interest, there is no repayment obligation that needs to be insured.

A mutual fund's assets belong to the fund and its investors, not to the trustee, the manager or portfolio manager who is responsible for administrative and portfolio investment decisions. In addition, a Canadian chartered bank or trust company, which must comply with banking and trust laws, acts as custodian, holding the assets of the fund.

A built-in safeguard for mutual fund assets is that they must, by law, at all times be segregated from those of the fund's trustee, manager and custodian. They are not available for any use or purpose other than the investment objectives of the mutual fund.

Are protections in place in case of insolvency and fraud?

Insolvency and fraud are not common for mutual fund managers and distributors; however, if either should occur, there are protections and legal options for investors.

Investor protection funds and/or contingency funds exist in certain provinces. These funds provide certain protections in the event of insolvency of a salesperson or mutual fund distributor, either because of business failure or fraud that leads to insolvency.

Except in Quebec, where there is a fund that protects in case of fraud of a distributor of financial products, there are no contingency funds that will cover situations where there is fraud but no insolvency. If fraud occurs, you should first see if the securities regulator is able to recover money for investors. After that, your option is to take legal action on your own or as part of a class action suit with other investors. The Centre for Financial Services OmbudsNetwork (CFSON) is available to guide you through this process. The following website is a good place to start:

CFSON - Consumer Assistance Information - Complaint Information Kit

It is important to note that the protection funds in other financial services areas, such as insurance/segregated funds and banking are also limited to situations of insolvency resulting from business failure or fraud of the insurer or bank, as the case may be.

Mutual fund distributors

Mutual fund *distributors* must be members of a self-regulatory organization, either the Mutual Fund Dealers Association of Canada (the MFDA), if they sell only mutual funds, or the Investment Dealers Association of Canada (IDA) if they sell other securities in addition to mutual funds. Both organizations have contingency funds in place to protect investors in the event of insolvency of a salesperson or mutual fund distributor.

The MFDA's Investor Protection Corporation (IPC) was approved in May 2005 by the securities commissions in Alberta, British Columbia, Nova Scotia and Ontario and by the Financial Services Commission in Saskatchewan as a protection plan for customers of mutual fund dealers that are members of the MFDA.

The MFDA IPC offers coverage to a maximum of $1 million per customer account and extends to all client assets held by the member in the event of insolvency (resulting from business failure or fraud). Further information is available on the MFDA website at www.mfda.ca. Click onto What's New and then Investor Protection Corporation.

The IDA's Canadian Investor Protection Fund (CIPF) protects customers of investment dealers who are members of the IDA. If you see "Member CIPF" on advertising literature, you will know that the distributor is an IDA member and covered by this fund. Coverage is $1 million per customer account and protects investors against the insolvency of a member firm. Further information is available on the IDA website at www.ida.ca. An information sheet is available at http://www.ida.ca/Files/Investors/Education/CIPFMillionDollar_en.pdf

If you invest in mutual funds and do not see "CIPF" on advertising literature, then you know that the MFDA's IPC is protecting you in the event of insolvency of a salesperson or mutual fund distributor.

As mentioned earlier, Quebec has a slightly different contingency fund that protects clients of firms and representatives distributing financial products and services . Please visit www.lautorite.qc.ca to find out more about this fund.

Mutual fund managers

There are currently no investor contingency plans in place for mutual fund *managers.* However, investor funds, by law, are to be kept by a custodian (either a bank or trust company) and the assets are kept in trust and separate from any other business of the manager.

What happens in a case of suspected fraud?

If fraud is suspected, regulators will step in immediately to freeze assets, investigate the situation or otherwise act in the best interest of investors. The provincial securities regulator may publish information for investors on its website. The regulator may recommend that investors await the outcome of the investigation before making any decisions.

Fortunately, most mutual fund investors never encounter a situation of insolvency or fraud, but we want you to understand about protection of mutual fund investments - this is an important consideration in making choices.

We also want to remind you of some of the key reasons why a majority of Canadians choose, and financial advisors recommend, mutual funds over other investment options:

- ✓ they offer diversification, which means access to a much wider range of investment options and markets than investors can achieve on their own;
- ✓ they offer professional money management;
- ✓ most are liquid investments - investors can sell them at any time;
- ✓ they allow individuals to easily invest small amounts at regular intervals;
- ✓ there is an extensive regulatory framework in place to protect mutual fund investors.

Questions or Comments?

Contact us at: investorinformation@ific.ca