May 9, 2005

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

On February 25, 2005, the Ontario Securities Commission (the "OSC") published for comment the Application (the "Revised 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 Revised Application was published in Volume 28, Issue 8 of the Ontario Securities Commission Bulletin, dated February 25, 2005. 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 Revised Application followed the application (the "Initial Application") by MFDA and IPC made to the CSA Members in November 2002 and published in Volume 25, Issue 48 of the Ontario Securities Commission Bulletin dated November 29, 2002. Public comments were received in respect of the Initial Application and such comments were summarized and responded to by MFDA and IPC and such summary and responses were published in Volume 28, Issue 8 of the Ontario Securities Commission dated February 25, 2005. The responses of MFDA and IPC with respect to the Initial Application were directed to be read together with the Revised Application.

The Revised Application included a copy of 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 Revised Application addressed the subject of the seven criteria identified by the CSA Members and reproduced as the Approval Criteria in the Revised Application. A draft proposed order (the "Order") and draft terms and conditions to such Order were also published for comment with the Revised Application.

The public comment period in respect of the Revised Application expired on March 28, 2005. Fourteen comment letters were received during the public comment period:

1. Royal Mutual Funds Inc. (“RMFI”) (March 30, 2005).

2. Worldsource Financial Management Inc. (“Worldsource”) (March 29, 2005).

3. BMO Investments Inc. (“BMOII”) (March 28, 2005).

4. Independent Financial Brokers of Canada (“IFB”) (March 28, 2005).

5. Investors Group Financial Services Inc. (“IGFS”), on behalf of IGFS. and M.R.S. Inc. (March 28, 2005).

6. Lawton Partners Financial Planning Services Limited (“Lawton Partners”) (March 28, 2005).

7. PFSL Investments Canada Ltd. (“PFSL”) (March 28, 2005).

8. Small Investor Protection Association (“SIPA”) (March 26, 2005).

9. IPC Investment Corporation (“IPCIC”) (March 25, 2005).

10. Martin + Becker Financial Management Ltd. (“Martin and Becker”) (March 25, 2005).

11. Canadian Bankers Association (“CBA”) (March 24, 2005).

12. The Investment Funds Institute of Canada (“IFIC”) (March 24, 2005).

13. David Hawkins (March 11, 2005).

14. Rissling Financial Corporation (“Rissling”) (March 3, 2005).

In addition, eight comment letters were received in response to MFDA Bulletin #0102-P MFDA Investor Protection Fund Update, issued October 14, 2004. A summary of these comment letters has also been incorporated into this document.

15. Federation of Independent Mutual Fund Dealers (the “Federation) (February 4, 2005).

16. Legacy Associates Inc. (“Legacy”) (December 12, 2004).

17. Susan Monk (PEAK Investment Services Inc.) (November 1, 2004).

18. Sean McGratten (Dundee Private Investors Inc.) (October 25, 2004).

19. Sinclair-Cockburn Financial Services Inc. (Sinclair-Cockburn) (October 15, 2004).

20. Tradex Management Inc. (“Tradex”) (October 15, 2004).

21. Lawton Partners (October 14, 2004).

22. Generation Financial Corp. ("Generation") (October 14, 2004).

Copies of comment submissions may be viewed at the office of the MFDA, 121 King Street West, Suite 1000, 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 Revised Application. A number of the comments received in respect of the Revised Application were similar to those received in respect of the Initial Application and reference should be made to the responses of MFDA and IPC in that regard and referred to above.

MFDA Response

1. General Comments

Most commentators expressed support for the general goal of investor protection but expressed concern with various aspects of the IPC as proposed. In particular, many of the comments received in respect of the Revised Application reflected common concerns regarding the lack of coverage for client name assets, the proposed assessment method, the size of the fund and IPC advertising requirements. The substance of these comments is set out below.

A few commentators 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.

Rissling was of the view that with proper monitoring of capital requirements and internal controls for handling client investments, the solvency of mutual fund dealers should not be an issue for investor protection. This commentator felt that the compliance role of the MFDA was the key factor in investor protection as opposed to a protection fund.

Rissling was of the view that if an IPC is to be created, then participation should be voluntary. If a voluntary IPC is developed, those members that join will articulate the value of the fund to the marketplace and those clients who view the protection as advantageous will be drawn to those members who are part of the IPC.

MFDA Response:

MFDA and IPC have confirmed with the CSA Members that a fund or similar protection plan is necessary. The respective Boards of MFDA and IPC have confirmed a protection fund as being in the public interest and have also recognized that a plan similar to that of

the Canadian Investor Protection Fund is in the interest of MFDA members for competitive reasons. MFDA and IPC do not believe that a wholly voluntary fund would be sustainable or fair to the industry at large which will benefit from the fund regardless of who is a member. However, it is acknowledged that there are a number of aspects of the protection plan proposed for customers of MFDA members that may require review and evaluation after the plan begins providing coverage and experience in the regulation and risks of mutual fund dealers has been gained. In this regard, the recurring public comments with respect to coverage for client name assets, proposed assessment methods, the size of the fund and advertising requirements will be addressed. The creation of a Working Group by MFDA IPC (as proposed to be a condition of the Order in respect of the Revised Application) will provide a forum to review and report findings to the MFDA IPC and CSA Members with respect to the relevant issues.

2. IPC APPLICATION AND APPROVAL PROCESS

2.1 Lack of Member Input in Development of IPC

The CBA, RMFI and BMOII felt that MFDA Members have not had sufficient opportunity to provide input into the Revised Application or the method of assessment of the IPC. IFIC, IPCIC and RMFI noted that some of the previous submissions by the industry participants have not been given sufficient consideration in the Revised Application.

Several commentators were of the view that there has been a failure to undertake the necessary research and analysis, particularly in relation to the relevant risks, that should provide the basis for the IPC.

MFDA Response:

MFDA and IPC are of the view that there has been ample opportunity for MFDA members to provide input into all issues relating to the establishment of the protection fund of IPC. In this regard, the public comments in respect of both the Initial Application and the Revised Application themselves contain specific, substantive and useful suggestions, all of which have been carefully considered by MFDA and IPC. In addition, MFDA and IPC themselves are member organizations and their constitution, as well as MFDA's recognition orders and the proposed Approval Order for IPC, require that the diversity of interests of all members be represented and, in fact, such interests are represented. Apart from the foregoing, MFDA and IPC have made extended efforts to communicate directly with members not only in inviting comments but also requesting that relevant information relating to specific issues about the plan and its consequences to members be provided. For example, in evaluating whether MFDA should participate in CIPF during the summer of 2004, detailed questionnaires relating to capital, assessment methods and other matters were requested of members. The efforts of MFDA and IPC in seeking input from members were directed in particular to smaller members which may not have the resources to analyze and comment on IPC's plan or the industry association representation to be assured such analysis and comment will be provided for them. MFDA, IPC and their staff and advisers have met on several occasions during the

development of IPC with representatives of larger members and organizations such as the Canadian Bankers Association and fund managers represented by IFIC.

Notwithstanding the foregoing, MFDA and IPC welcome the establishment of the Working Group as proposed and expect that it will provide further opportunity for members to have input into the future development and operations of the plan.

The matter of whether appropriate research and analysis with respect to risks in the mutual fund distribution industry is available has been acknowledged in the sense that very little information of the relevant kind is available. This is true for securities industry compensation plans both in Canada and in the United States. However, the persons (including members, MFDA staff, advisors and others) involved in the development of IPC have had considerable experience in the mutual fund industry and dealer insolvencies and are able to provide a reasonable assessment as to the risks and implications of IPC coverage. As stated in response to comments on the Initial Application, it is expected that as experience and knowledge is gained while IPC operates, its structure, coverage and operations could be modified.

2.2 IPC Working Group

The CBA, IFIC, RMFI and BMOII supported the creation of the IPC Working Group (as set out in section 10 of Schedule A to the draft Order in the Revised Application), which will be mandated to review various aspects of the IPC once it is approved and operational. The CBA, RMFI and IFIC made specific comments respecting the timing of the Working Group's report and the mandate of the Working Group.

The CBA and RMFI felt that the Working Group should be established prior to the approval of the IPC to ensure adequate industry input. RMFI recommended that the establishment of the IPC be delayed to allow the Working Group a six month period to meet, deliberate and provide a report containing recommendations. RMFI felt that the report and any summary of the Working Group's findings prepared by the IPC Board of Directors should be made public. In the alternative, should the CSA not be prepared to delay the approval of the Revised Application to allow for preparation of the Working Group's report, RMFI suggested that CSA approval be granted provisionally, with formal recognition of the IPC by the CSA made conditional upon the incorporation of the recommendations of the Working Group into the Revised Application. RMFI also proposed that once recommendations have been delivered, they should be reflected in changes to the structure and practices of the IPC prior to any fees being assessed in 2006.

IFIC commented that is unclear whether the Working Group will have a mandate to review various aspects of the IPC on an ongoing basis or whether the Working Group will expire after the first written report to the IPC Board of Directors and the OSC has been issued. IFIC was of the view that the mandate of the Working Group should not be limited in this way, as it would serve to remove the operations of the MFDA IPC from the ongoing scrutiny of MFDA Members. IFIC recommended that section 10 of Schedule A to the Revised Application be amended to explicitly state that the mandate of the Working Group will be to assess and make recommendations with respect to various

aspects of the IPC on an annual basis so long as the IPC is operational with the role of MFDA Member representatives of the Working Group being likewise continued as active participants and not observers.

In addition, IFIC suggested that the Working Group be permitted to submit its first report to the IPC Board of Directors and to the OSC prior to the issuance of the second year's assessments (within six months from the date of the OSC's approval of the IPC). IFIC also recommended that, in addition to the IPC Board of Directors and the OSC, the Working Group report should be submitted directly to the CSA. In the interest of transparency, the Working Group's report should be made public at the time of its submission to the IPC Board of Directors, the OSC and the CSA. IFIC also recommended that the MFDA IPC Board evaluation of the Working Group's findings be provided to the Working Group in addition to the OSC.

MFDA Response

The MFDA and IPC are not in a position to determine whether the establishment of IPC should be delayed to permit the Working Group a period of time to prepare recommendations. That is, in part, a matter for the CSA Members to decide but MFDA and IPC believe that it is in the interests of members and the public to commence the coverage that was announced several years ago and then make appropriate adjustments on the basis of ongoing reviews. In addition**,** based on the experience of MFDA and IPC in the establishment of the plan to date, the proposal for even a six month period to permit further deliberation and reporting on recommendations would for practical purposes delay the commencement of coverage of any plan for a period of at least two years. This is based on the time required to have recommendations considered, prepare and confirm an appropriate new structure, seek membership review and comment, seek and respond to public comments and then leave time for implementation and preparation by members for coverage to commence. This time projection is entirely consistent with the development of the IPC Plan to date.

MFDA and IPC understand that the Working Group would review and report to MFDA IPC and CSA Members on a wide range of matters relating to the operations of IPC including risks, fund size, products covered, customer accounts, assessment methodology, funding and risk management tools. In fact, most of those kinds of issues are linked and cannot be reviewed individually. One of the initial tasks of the Working Group would be to identify the matters that it wishes to address.

It is the view of MFDA and IPC that commitments as to the operation of the fund including matters relating to second year assessments should be determined after the work of the Working Group has been completed and findings have been reported. The nature of the issues involved do not ensure that there will be unanimity in any findings and during the time that the findings are being reviewed and considered by the MFDA, IPC and CSA members, IPC must maintain its coverage on the basis proposed in the Revised Application. With respect to the use and dissemination of the Working Group's findings, MFDA and IPC are of the view that those matters could be reported on by the Working Group itself and included in their findings. At present, MFDA and IPC are not

aware of any reason why the process would not be entirely transparent but there may be sensitivities identified by the Working Group that should be assessed by that group.

3. CORPORATE GOVERNANCE

The CBA, RMFI and IFIC felt that the provision for representation of the industry on the Board of Directors of the IPC was insufficient as the definition of "Industry Directors" includes directors, officers or employees of the MFDA.

The CBA and RMFI believed that the term "Industry Directors" should be redefined to only include those individuals who are directors, officers or employees of MFDA Members. The CBA and RMFI suggested that it would be appropriate to permit the appointment of one or more directors, officers or employees of the MFDA as non-voting ex-officio members of the Board.

IFIC stated that the governance structure of the IPC should adequately ensure that MFDA Members have an opportunity to provide meaningful input at the IPC Board level and suggested that it might be desirable to provide a guaranteed place for MFDA Members on the IPC Board of Directors. To this end, IFIC recommended that: (i) the definition of "Industry Directors" be amended to include only MFDA Members; (ii) Industry Directors not be subject to removal from office without the consent of the MFDA; and (iii) the MFDA's ability to appoint or elect Industry Directors should not be subject to the approval of the IPC Board of Directors.

Tradex suggested that it would be more efficient for the MFDA and the IPC to have the same Board of Directors, particularly since it is contemplated that the IPC would be an interim vehicle.

Rissling felt that MFDA Members should have the right to vote for the IPC Board of Directors. Rissling commented that the IPC Board of Directors should not have the power to select its replacement members as this would result in an inherent bias. Rissling further noted that while a nominating committee of the IPC Board could make its nominations for future members of the Board, this should not preclude other nominations from MFDA Members.

The SIPA noted that the majority of the Board, including the Chair, should be independent so that investors will have confidence in the IPC's operations and process for dealing with claimants.

MFDA Response

Careful consideration has been given to the governance structure of IPC. Some of the more important principles that have been determinative of the corporate structure are: IPC is a passive fund and relies on MFDA and its rules for risk management purposes; the interests of MFDA members as responsible for funding IPC should be appropriately represented; and to the extent that IPC is considering and paying claims of customers of

insolvent members of MFDA, IPC must be seen to be independent of the mutual fund industry. Accordingly, it was determined at an early stage of IPC's development that a majority of the Board of Directors should be comprised of independent or non-industry directors and that after an initial organizational period for IPC its Chair would only be considered as a public director if he or she did not have employee/management functions with IPC. MFDA and IPC believe that this independence is critical to public confidence in IPC. The principles described above preclude IPC having the same Board of Directors as MFDA.

With respect to which persons may be considered and appointed as "Industry Directors" of IPC, MFDA and IPC consider that the best judge would be MFDA itself. This view is based on the fact that MFDA is the mutual fund dealer industry SRO and can assess who should represent the members and the industry on the IPC Board. Accordingly, proposed By-laws of IPC provide that only MFDA nominees can be appointed as Industry Directors of IPC. Such persons are also restricted to directors, officers or employees of the MFDA or members of the MFDA. If MFDA considered that it was not appropriate for officers or employees of MFDA itself to be Industry Directors of IPC, MFDA would not nominate them.

4. COVERAGE

4.1 General Comments

Rissling commented that the IPC would create an "expectations gap" between investor's perception that the IPC will cover investment losses created by market fluctuations and actual IPC coverage. The commentator was of the view that this "expectation gap" may have a more negative impact on investor confidence than having no protection fund at all.

SIPA was of the view that all holdings with a dealer should be covered unless specifically identified as a noninsured security or account. SIPA also commented that there should be assurance that if a troubled firm is unable to make its fee payments to the MFDA or its contributions to the IPC, that insurance coverage will still be provided. SIPA expressed concern that if any action is taken to terminate a MFDA Member's membership that insurance coverage would be negated.

SIPA also commented that the risk assessment system should be sufficiently responsive to provide an early warning sytem and timely appropriate action.

MFDA Response:

IPC is intended to cover the insolvency risk of MFDA members and, in that regard, it is similar to Canadian Investor Protection Fund in Canada and Security Investor Protection Corporation in the United States. The fact that there may be an "expectation gap" for some investors has been illustrated in the experience of both CIPF and SIPC. However, it is impossible for a fund such as IPC to cover the gap and the suggested alternative of no protection fund at all has not been accepted. Therefore, the best response to the concern is to ensure that appropriate public disclosure and information is available to

customers so that there is a clear understanding of what risks are covered. In addition, IPC coverage is intended to apply to all holdings that a customer has with a member.

IPC coverage is automatic as long as the member is a member of MFDA and regardless of whether its assessments have been paid. Customers should not be put at risk once coverage has been available because of the unwillingness or inability of a member to pay assessments. In such cases, steps would be taken to terminate membership and ensure that customers have an opportunity to transfer their accounts to another member. MFDA's regulatory monitoring includes early warning mechanisms to identify potential risks.

4.2 Lack of Coverage for Client Name Assets

Many commentators were concerned that the IPC would be of very limited benefit to the industry and investors because it will not provide coverage to assets held in client name. Some commentators suggested that the coverage should be extended to client name assets. The Federation commented that establishing an IPC that only covers nominee name assets could only be perceived as a partial solution at best. The Federation supported the idea of an industry-wide contingency fund that would involve fund company participation and cover client name assets as well.

Several commentators were concerned that the recognition of an investor protection plan which leaves the majority of customer assets held by mutual fund dealers without coverage may result in significant investor confusion or create the false expectation that assets are covered when they are not.

IFIC was of the view that either more work should be done to determine how client name assets might be brought within the IPC coverage or MFDA Members in client name should not be required to contribute to the same extent towards coverage that will only remotely apply to their clients.

IGFS commented that the distinction between operations in client name and operations in nominee name should be clearly understood and comprehensive definitions and guidelines should be developed and documented.

Lawton Partners felt that there should be clarification that the IPC will cover client cash if held in client name.

MFDA Response:

The matter of "coverage for client name assets" has been raised by a number of commentators during the course of the development of IPC. The solution suggested by some commentators is that IPC coverage should be extended to client name assets. Proposals of this kind raise the question of what "coverage" means in the context of IPC and its insolvency loss protection. IPC protection protects property held by members as intermediaries for customers if a member becomes insolvent. Client name coverage refers to protection of the clients' rights as against the issuer of an investment product. For instance, if insolvency loss protection is to be extended to client name assets that are

held by mutual fund managers, then a protection fund covering the insolvency of mutual fund managers would have to be created. That is well beyond the mandate of MFDA and IPC.

It is recognized that the relationship between funding and coverage may be distorted to the extent client name assets are not the responsibility of MFDA members and therefore are not subject to IPC coverage. On the other hand, insolvency losses can and do arise with respect to dealers whose clients' assets are held in either nominee or client name. Client property that may be at risk includes cash handled by a dealer or assets that a dealer or its representatives are able to control. The risk often arises because account arrangements that are generally referred to as client name may involve the member actually holding or controlling client assets that are intended to be held in client name. In addition, it is difficult to segment the industry for the purpose of determining the overall benefits of protection for all customers of mutual fund dealers. It will be one of the subjects of the Working Group to review whether the relationship, for instance, between IPC assessments and the nature of a dealer's business is fair.

4.3 Products Covered

IFB felt that increasing coverage to include all assets in client accounts (including assets which are not mutual funds or cash) yet excluding mutual fund assets held in client name is inconsistent with the objective of investor protection. This commentator also questioned whether expanding the range of assets covered to include other non-mutual fund products was beyond the jurisdiction of the IPC. The commentator stated that some of the non-mutual fund assets proposed for coverage by the IPC are already covered by other forms of consumer protection insurance resulting in double coverage and no actual increase in consumer protection.

The CBA noted that several definitions with respect to assets covered under the IPC were unclear. In particular, several different terms are used throughout the Revised Application in reference to assets covered under the fund: “financial products”, “client property eligible for protection” and “financial investment products”. The CBA also wondered how a mutual fund dealer can hold segregated funds for a client, given that they are insurance contracts and are not considered securities. This commentator was also of the view that the definition of “customers” required clarification.

MFDA Response

The range of products proposed to be covered by IPC under the Revised Application has been expanded to include all assets held in a client's account. Typically, this could include mutual fund securities, permitted exempt securities, deposits, segregated funds and other kinds of products. The scope of coverage contemplates some flexibility in that the IPC Board has discretion as to payments and defining by its coverage policy what is to be included. It is the view of MFDA and IPC that there will be less confusion for consumers by adopting a broad definition of products covered because it is difficult for consumers to distinguish among the variety of financial products available, many of which require technical understanding and often resemble other products. IPC has the

jurisdiction to provide coverage with respect to whatever property held by an MFDA member is considered appropriate. The risk of double coverage with respect to products for which there may be other compensation available is minimized by virtue of the fact that IPC would expect to pay last. For example, if a deposit instrument were held in an MFDA account and CDIC coverage were available if the instrument was not recovered, IPC would expect CDIC to pay the loss. This would only arise, of course, if the issuer of the deposit instrument were insolvent; otherwise, IPC would be responsible for the failure of the insolvent member to deliver the deposit instrument or its value to the eligible customer.

The need for clear explanations and definitions with respect to products covered and customers eligible for protection is acknowledged. IPC has attempted to benefit from the extensive experience of CIPF in respect of analyzing claims by customers and determining who should be eligible for protection as a customer of an insolvent MFDA member. It is further acknowledged that some of the distribution structures and customer relationships in the mutual fund industry differ from those of investment dealers who are members of CIPF and these differences should be accommodated in IPC's protection plan coverage.

The matter of holding segregated fund products (which are insurance policies) has been under review in the securities industry and it is acknowledged that "holding" such products is not on the same basis as that of securities. The customer should remain the insured.

5. FUND SIZE

The Federation and IPCIC questioned whether the proposed size of the fund is appropriate. The commentators noted that there was no discussion in the IPC Application as to how the size of the fund was determined. The Federation was of the view that it was necessary to provide a detailed explanation of the methodology used to establish the proposed fund size of $30 million to MFDA Members. The Federation noted that the IPC target fund size of $30 million was discussed prior to the proposed increase in coverage from $100,000 to 1 million, which suggests that either the initial target fund size was significantly overstated or that initial coverage estimates were significantly understated.

The Federation also noted that the proposed fund size as a percentage of the assets that would be covered under the fund represented a much larger percentage than the size of the CIPF in proportion to the total AUA of the assets covered under the CIPF. The Federation was of the view that this would be justified if the business model used by MFDA Members carried significantly greater risk than the business model used by IDA Members, however the Federation did not feel that this was the case. The IPCIC suggested that the amount of the IPC might be excessive given that there is no record of mutual fund dealer insolvencies.

SIPA noted that, while it was not in a position to comment on the adequacy of the proposed $30 million fund size, it was not uncomfortable with the $1 million coverage

per account. SIPA was also of the opinion that a five-year automatic review mechanism for assessing the adequacy of the level of coverage should be implemented, which should consider factors such as inflation, asset appreciation and demographics. In addition, SIPA recommended that should the protection fund turn out to be inadequate, there should be a clear understanding and obligation that industry participants make up any difference in payout.

MFDA Response

The proposed size of the fund of assets to be initially maintained by IPC has been determined according to best estimates as to the risk of losses occurring as well as revenues required (by way of assessments and investment income) to maintain IPC's operations. The fund held by IPC at any time represents only the prefunded portion of losses that IPC may have to pay. If the eligible losses exceed the amount of assets IPC then holds, IPC through MFDA would have to make assessments or borrow funds to cover any shortfall.

It is acknowledged that a review of the proposed fund size will be one of the tasks of the Working Group. Apart from the role of the Working Group, the Revised Application provides that the fund size will be reviewed by MFDA and IPC at least annually in any event. The relationship between the size of the fund and the per account coverage of $1 million for eligible customers will be one of the factors considered. However, the increase of per account coverage to $1 million under the Revised Application was accompanied by a proposed immediate $30 million fund size rather than an initial $5 million with a target of $30 million in five years. Accordingly, the size of the fund was increased to accommodate the greater per account coverage.

6. AMOUNT OF ACCOUNT COVERAGE

IFB was strongly opposed to the proposal to increase client account protection to $1 million from the previously proposed $100,000. IFB was of the opinion that the $1 million coverage per account was excessive and expressed concern with the fees that would be necessitated in order to support such a level of protection. IFB stated that coverage of $100,000 is more in line with consumer protection available in other segments of the financial industry (CDIC and CompCorp) and more accurately reflects the low risk of failure within the mutual fund industry in Canada. IBF felt that setting the level of account protection at $1 million would decimate the fund quickly in the event of large claims and noted that the $100,000 coverage level was adequate for many mutual fund clients given that mutual funds have traditionally been the favoured investment choice of smaller investors. It was also suggested by IFB that the $100,000 coverage level would be less financially onerous on sales representatives who, without proper controls placed on dealers, will be the ones covering the cost.

MFDA Response

There has been relatively strong support among mutual fund dealers to have the per account protection correspond to that available from CIPF. This view was strongest

amongst members who may have affiliates who are CIPF members, but many members without such affiliates were of the view that similar coverage was important for competitive reasons and reducing confusion among customers of distributors of financial products and services. On the other hand, it is true that most expected losses in a mutual fund dealer's customers' accounts in the event of insolvency would be much less than $1 million and likely under the $100,000 coverage level. This is accounted for by statistics relating to the average size of customer accounts with MFDA members across Canada. As well, equally importantly, because of the effect of the pooling of losses under Part XII of the *Bankruptcy and Insolvency Act* (Canada), the likelihood of losses per customer account approaching $1 million are (in the view of MFDA and IPC) relatively remote.

7. FUNDING AND ASSESSMENTS

7.1 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.

Several commentators sought clarification as to how money in the existing provincial contingency funds will be handled and whether it will be incorporated into the IPC or returned to dealers. The Federation recommended that any existing provincial contingency fund deposits be returned to MFDA Members (subject to any limited term holdbacks relating to potential insolvencies where provincial payouts will be required). The Federation also commented that the provincial commissions should provide dealers with information on the size of the funds, details of claims made on these funds, their returns (if any) and their present status. Martin and Becker believed that the OSC should not approve the Revised Application until it has announced how and when it plans to return the contingency fund deposits to mutual fund dealers.

Generation sought clarification as to whether, once the IPC is established, the MFDA would contact provincial securities regulators in Manitoba and Saskatchewan to provide relief for smaller dealers from surety bond requirements in the respective provinces.

MFDA Response:

MFDA and IPC are very aware of the concerns regarding costs in the form of fees and assessments for mutual fund dealers and for that reason have attempted to minimize such fees and costs without prejudicing the protection to be available to the public.

The future of the existing provincial contingency funds maintained in British Columbia, Ontario and Nova Scotia will be determined by the relevant CSA Members and are not within the jurisdiction of IPC or MFDA. However, the understanding is that mutual fund dealers who are currently participating in such plans will not be required to continue such participation after IPC is established. The return of funds or deposits in such plans will be determined according to the terms of the plans and any liabilities that such plans may have. It is not expected that funds in those plans would be directed to IPC. One of the

reasons that financial institution bonds are required for MFDA members relates to risk management for IPC and MFDA. Any relief from FIB requirements would be assessed from that perspective and IPC coverage is not intended as a substitute for commercial insurance required of each member.

7.2 Assessment Methodology

7.2.1 Assessments on Client Name Assets

Many commentators were of the view that levying assessments on the basis of total assets under administration ("AUA") while not providing coverage for client name assets would be inequitable. 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.

The CBA, BMOII, RMFI commented that the proposed assessment methodology based on AUA would be inequitable and unreasonable since they would be required to pay substantial assessments, yet neither they nor their clients would derive much benefit from the IPC as client name assets are not covered.

Several commentators noted that the proposed AUA assessment methodology discriminates against mutual fund dealers that hold customer assets in client name compared to those that hold customer assets in nominee name. It was also noted that the proposed assessment methodology would result in significant and inequitable cross-subsidies from MFDA Members who deal in client name to those who deal in nominee name and as between larger and smaller dealers.

Several commentators noted that if client name assets are not covered than they should not be subject to assessment. If however they are to be assessed, they should be entitled to the same protection as nominee name assets. Legacy recommended that assessments should be based on the makeup of a dealer's AUA, with dealers that have nominee name accounts paying higher fees than dealers with little or no nominee name accounts.

MFDA Response:

Reference is made to the MFDA response in respect of item 4.2 above including the fact that assets held in client name can be at risk in a dealer insolvency**.** It is expected that the Working Group will review the substantive comments that have been made. In the context of the initial establishment of IPC and its fund, it was felt strongly that the convenience of using an assessment basis that matched the MFDA fee structure was appropriate. All mutual fund dealers will be beneficiaries of a protection fund to the extent that public confidence is enhanced and risk of client loss can be reduced. Moreover, IPC assessments according to AUA may be seen as a reasonable proxy for the risks involved. The high risk assets are cash and short term liquid securities handled by dealers and their representatives, and the fact that a mutual fund investment may ultimately be held in client name does not resolve all risks to customers.

7.2.2 Need for Risk Based Methodology

A number of commentators noted that the IPC assessment methodology does not allocate costs on the basis of risk. These commentators indicated that the IPC assessment methodology should address the higher risks associated with a dealer's operations including the holding of assets in nominee form and the sale of prospectus-exempt products (including limited partnerships and hedge funds) and other instruments not covered under National Instrument ("NI") 81-102. The CBA submitted that regulators should, in the context of any formal approval of the Revised Application, expressly acknowledge that AUA is not an appropriate proxy for risk and that funding should be substantially risk based.

The CBA noted that differentiating the cost of IPC coverage for non NI 81-102 products, in addition to being more equitable, would also serve to highlight for dealers the additional risk and corresponding burden of care that comes with such products. The CBA also noted that IPC coverage will cover securities, cash and property held by the Member, including segregated funds, which CBA members are prohibited from selling but will be required to cover through assessments.

Several commentators suggested that Members assessed as having a low potential risk of loss should be given a rate reduction while those assessed as higher risk could be assessed at a higher rate.

Lawton Partners was of the view that IPC assessments should be based on a reasonable measure of the perceived risk to the client's assets. Lawton Partners commented that given the MFDA Rules and requirements in place with respect to monthly reconciliation of bank balances, segregation of client assets and monthly financial reporting it should be quite straightforward to isolate assets most at risk at an insolvent client name dealer and assess a fee for the IPC accordingly. Lawton recommended that the MFDA IPC assessment methodology should recognize the fact that nominee name and client assets are subject to substantially different risk in dealer insolvencies. Lawton suggested that the proposed AUA formula be discounted by at least 50% for client name dealers until such time as the IPC is in place, and going forward should be based on the client's actual assets at risk in a dealer insolvency.

Tradex recommended that total revenue rather than the AUA should be used as the basis for assessment since revenue provides a better measure of risk and thus would be more equitable. In addition, Tradex stated that basing fee assessment on revenue would be consistent with the CIPF model and would facilitate a future merger with the CIPF.

The Federation questioned why the IPC would only be able to rely on experience going forward in order to assess the risk associated with mutual fund dealers. The Federation noted that the mutual fund dealer registration category has been around for some time and that provincial securities commissions and the IDA maintain records with respect to mutual fund dealer insolvencies.

MFDA Response:

The many comments raised with respect to a risk based assessment methodology for IPC deserve careful consideration and it is expected that they will be the subject of the Working Group's review. MFDA and IPC acknowledge in principle that an assessment methodology that reflects risks is important. However, risk based assessments may not be the only appropriate approach if the overall viability of IPC protection cannot be maintained and the direct and indirect benefits of the fund protecting customers of the mutual fund industry are not taken into account.

7.2.3 Initial Assessments

Rissling was of the opinion that the initial assessment was unfair because current Members would have to contribute to the fund twice. He noted that current Members would have to pay the initial assessment to bring the IPC up to 30 million and subsequent assessments for claims history from the date inception forward. Members joining after five years would only be assessed to cover the claims history. Rissling recommended that every Member (current and future) be assessed based on anticipated claims history and pay a separate surcharge which would be directed towards the initiation of the fund.

MFDA Response

The matter of fairness among members who contribute assessments on the initial implementation of the plan and members who participate subsequently deserves consideration. The fact is, however, that initial assessments can only come from current members. If the fund were to reach its target size and an assessment holiday, in effect, were in place, it would be expected that members joining after that time would be assessed for a period of time. For instance, in that circumstance CIPF requires new members to be assessed for a period of five years. In any event, it is expected that the Working Group would review this matter.

7.2.4 Other Funding Sources

BMOII recommended that innovative funding sources be considered; such as using interest from dealer trust accounts to fund the IPC. BMOII noted that currently the interest that accrues on dealer trust accounts is paid to the mutual fund the interest relates to. BMOII further noted that interest accounting is a laborious task, which provides nominal revenue to the funds and in virtually all cases is unlikely to affect the net asset value per unit of the fund. If such interest were used to fund the IPC, the costs to MFDA members associated with administering these interest payments would be greatly reduced (as there would be only one payee) and there would be an identifiable benefit from the monies in the IPC. BMOII noted this interest alone may not be sufficient to fund the IPC, however, such a solution would provide significant benefits to consumers while dramatically reducing costs to the industry.

MFDA Response

MFDA and IPC have considered a number of alternate funding sources as outlined in the Revised Application. With respect to interest on dealer trust accounts, the matter has

been raised specifically with CSA Members on more than one occasion and has been rejected to date. Again, the Working Group may wish to make findings in that regard.

8. ADVERTISING RELATED TO IPC COVERAGE

8.1 Potential for Investor Confusion

The CBA, RMFI, BMOII, IPCI and IFIC noted that proposed Rule 2.7, which mandates advertising of IPC coverage while prohibiting the inclusion of any statement or explanation relating to the IPC other than the MFDA IPC official symbol and referral statement, could potentially be confusing and misleading to clients since client name assets would not be covered. BMOII was of the view that approval of the advertising requirements should be postponed until there has been industry and consumer consultation and an effective IPC communication strategy is fully developed.

IFIC and IPCIC noted that proposed Rule 2.7 will require the MFDA IPC symbol and official explanatory statement on client name account statements despite the fact that no assets on the statement would be covered. RMFI commented that Rule 2.7 would require dealers that operate in client name and whose clients are not protected by the IPC to create and distribute new documents and revise existing client statements at considerable expense. IPCIC and IFIC suggested that client name statements be exempted from the requirement to include the IPC symbol. As an alternative, IFIC recommended that the requirement to disclose IPC coverage should apply at the account or position level (i.e. for each security) rather than on the document as a whole.

IFIC commented that the MFDA IPC official explanatory statement is misleading as it states that customers' accounts are protected within certain limits, and refers to the IPC brochure. IFIC noted that only certain accounts are covered and that without qualifying the statement by adding the word "certain" to "customer accounts", many investors will erroneously believe that all accounts and assets are covered.

BMOII noted that their dealer activities operate primarily out of BMO bank branches and expressed concern that the posting of the IPC symbol and referral statement will lead customers of banks to infer principal protection similar to that offered by CDIC.

MFDA Response:

MFDA and IPC recognize the importance of ensuring that there is clear communication to the public as to the nature and extent of IPC protection. This objective is important from the point of view of customers, MFDA members, as well as for IPC itself as a risk management matter. The fact that IPC coverage is available is important to communicate to customers. The proposed disclosure is intended to be minimal in the sense that the purpose is to direct customers to IPC's brochures and public coverage policy for details. It is not practical or prudent to attempt to define the details of IPC coverage, including whether or not client name assets may be covered, in advertising or customer account or trading documents. With respect to the matter of client name assets, the same issue arises with respect to other protection funds such as CIPF and SIPC in the United States and

there is little evidence of customer confusion. The possibility of confusion with protection plans for other products such as CDIC would arise because of the choice of a financial institution to deliver multiple products through the same branch – not because of the existence of IPC or an IPC symbol. Dealers will be required to ensure that customers are not misled**.**

The matter of advertising and use by members of references to IPC could be the subject of the Working Group's review.

8.2 Corporate Groups

The CBA commented that section 2.7.4(h) appears to prohibit the use of the IPC official symbol in conjunction with the name of the dealer's umbrella corporate group. The CBA noted that this prohibition would have the effect of prohibiting the use of trade names associated with a mutual fund dealer's corporate family and also amount to a prohibition on consolidated account statements. The CBA was of the view that clear disclosure of which entity or entities operating under a corporate logo are members of the IPC would address concerns regarding customer expectations as to the extent of coverage.

IFIC was of the opinion that section 2.7.4(h) would also prohibit MFDA Members from relying on fund managers to issue trade confirmations on behalf of MFDA Members and thus contradict subsection 36(7) of the Ontario *Securities Act* and MFDA Rule 5.4.1, which expressly permit fund managers to send trade confirmations on behalf of mutual fund dealers. IFIC requested clarification of this point and submitted that the use of advertising with respect to IPC coverage should be determined by whether the assets reflected in the statement are covered or not.

MFDA Response:

It is important in communicating to the public the scope and nature of IPC coverage and, as a collateral matter, to avoid communication that would imply that coverage extended to affiliates or entities associated with MFDA members. This is a substantial and practical concern that arises in corporate groups. The provisions of MFDA Rule 2.7.4(h) are not intended to prohibit MFDA members from relying on fund managers to issue trade confirmations. Confirmations are dealt with under paragraph (c) of that section and if a member is sending the confirmation, it must include the MFDA IPC official symbol. However, MFDA and IPC acknowledge that clarification with respect to this matter and the requirement to distribute the MFDA IPC official explanatory statement should be clarified. This subject could be reviewed by the Working Group**.**

8.3 Other Specific Comments Regarding Advertising of IPC Coverage

The IPCIC expressed concern with the fact that its legal name, which is IPC Investment Corporation, is referred to by its clients as "IPC". IPCIC was of the opinion that using the same acronym for the protection fund would be confusing to its clients and requested that another phrase or acronym be used instead.

SIPA noted the increasing consolidation, affiliates and cross-ownership in the mutual fund industry and felt that great effort should be taken to ensure that investors understand exactly what organizations are covered by the IPC and which are not. SIPA suggested that a list of IPC Members should be posted on the Internet and should be available to clients in print form on request. In addition, SIPA commented that the nature and limitations of the coverage should be clearly documented in plain language, illustrate the coverage available under a number of different scenarios and be readily available to clients.

The CBA indicated that the "MFDA IPC referral statement" and the "MFDA IPC official explanatory statement" were not defined in the Revised Application. IFIC felt that the MFDA IPC official explanatory statement is misleading as it states that customer accounts are protected by the MFDA IPC within specified limits despite the fact that only certain accounts are covered.

MFDA Response

The members of MFDA who will all be covered by IPC are currently posted on the website of MFDA at www.mfda.ca and will continue to be available for customers to review and print at any time. The description of IPC's coverage and customer eligibility has been attempted to be as clear and plain as possible, recognizing that it is a relatively complicated and technical subject. The brochure anticipated by IPC will be simpler and plainer than the coverage policy. The definitions of "MFDA IPC referral statement" and "MFDA IPC official explanatory statement" are defined in Exhibit D to the Revised Application as part of the revisions under Rule 2.7.4. The statement that only certain accounts may be covered by IPC is not accurate because all accounts of eligible customers of IPC will be entitled to coverage. However, some assets owned by the customer such as client name assets may not be covered whereas cash associated with such client name accounts as well as other products would be covered. The matter of clarifying which entities as members of MFDA are covered is important and members are required to ensure that customers are not misled, particularly in the case of corporate groups. Reference is made to the response to Section 8.2.

9. IPC AS A PASSIVE FUND

IGFS, the Federation and IFIC were of the opinion that the IPC should rely on the MFDA to perform member examinations. The commentators were in agreement that granting auditing power or self-regulatory organization status to the IPC would create unnecessary costs and duplication of the MFDA's mandate.

MFDA Response

IPC has been structured as essentially a passive fund in the sense that IPC will rely primarily on MFDA to perform member examinations. However, IPC may either request MFDA to perform member examinations or perform them itself in certain circumstances where there may be risks to the fund's assets. MFDA and IPC will agree and co-operate in this regard. The proposed terms and conditions to the Order require that 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**.** MFDA and IPC are of the view that this degree of member review is important for IPC's risk management and will benefit the integrity of the fund and regulation of MFDA members.

10. FUTURE ASSOCIATION WITH THE CIPF

Legacy and IGFS were of the view that the MFDA IPC should remain separate from the CIPF. IGFS stated that if there is to be any future association with the CIPF, mutual fund dealers must be guaranteed meaningful participation in the governance of the CIPF, operating costs for mutual fund dealers must not be higher than under the IPC and the category of registration of mutual fund dealer must be continued.

The IFB was of the opinion that an association with the CIPF would be a better model than a separate fund. IFB believed that one fund would be less confusing for investors and provide opportunities for economies of scale, which would result in lower fees.

IFIC, while acknowledging that advantages could result from a merger of the MFDA IPC with CIPF, noted that CIPF was designed to meet the needs of investment dealers who have a fundamentally different business model. IFIC was of the view that a merger with CIPF should only be contemplated if and when CIPF is willing to accept MFDA Members on terms that are tailored to meet the needs of their dramatically different business models. In addition, MFDA Members should be given the opportunity to provide input on the terms of such merger and retain the right to approve or reject such a merger through the MFDA's governance process.

MFDA Response

As has been explained in the Revised Application, the prospect of MFDA becoming a regulating SRO with CIPF has been carefully reviewed and it was concluded that such arrangements were not able to be made in a reasonable period of time. However, the prospect of MFDA members participating in CIPF may be in the public interest and that issue will continue to be reviewed. There are obvious differences and similarities between the mutual fund industry and the business of investment dealers and the advantages and disadvantages of participation in CIPF would have to be assessed and balanced.

11. CLAIMS PROCESS

SIPA recommended that IPC act quickly to reimburse client losses in the event of insolvency and should not require clients to file claims but provide automatic reimbursement upon dealer insolvency. SIPA recommended that payments should be made to investor claimants within 60 days of the declaration of insolvency and should include accrued interest as of the date of insolvency. The interest should be additional to the $1 million coverage if not paid within 60 calendar days.

SIPA was also of the view that the insurance should be in Canadian dollar cash and/or the identical security(ies) and should ignore any DSC early redemption fees and other

penalties. SIPA commented that any cost recovery of premiums paid should be subsumed in the management fee. If not, the method of recovery should be uniform across the industry. SIPA also questioned how insurance funds would be applied to RRIFs where new contributions are not permitted, minimum annual withdrawal penalties prevail and there are income tax issues.

In addition, the SIPA was of the view that there should be a timely and effective appeal process in place for investors who disagree with the amount of restitution, and, if the appeal were unsuccessful, there should be civil remedies available to investors, as described in the Revised Application.

MFDA Response

MFDA and IPC agree that it is in the public interest that the accounts of customers of insolvent members be dealt with promptly and that any losses be reimbursed together with the ability of customers to trade or otherwise deal with their accounts. The ability of IPC to pay client losses and deal with client accounts is affected by the provisions of the *Bankruptcy and Insolvency Act* (Canada) and the duties and powers of a trustee in bankruptcy where the estate is administered under that legislation. IPC would expect to work co-operatively with a trustee in bankruptcy in the same manner that CIPF co-operates with a trustee in bankruptcy of an insolvent investment dealer. IPC does not anticipate paying interest on any claims after the date of the insolvency of a Member. This position is consistent with insolvency law principles in Canada and the United States including the policies of CIPF. The claims process of IPC will include an internal appeal for customers, and customers who disagree with any decision of IPC in that regard will be free to pursue any civil law remedies they may consider appropriate.

The amount of eligible loss recoverable from IPC is calculated as at the date of insolvency according to the value of property held but unavailable as a result of the insolvency. Accordingly, claims in respect of fees and premiums would not ordinarily be permitted. In the case of registered plans, it is possible to make arrangements with the relevant taxing authority such as the Canada Revenue Agency to reimburse for lost contributions.

12. NEED FOR A LEVEL-PLAYING FIELD FOR MUTUAL FUND DEALERS AND INVESTMENT DEALERS

Worldsource suggested that, in light of the implementation of the IPC and additional protection afforded by the fund, mutual fund dealers should be provided with similar privileges as investment dealers. The commentator stated that since capital requirements for the two types of dealers are essentially the same, both types of dealers should be allowed to compete equally without undue restrictions on mutual fund dealers. Worldsource was of the view that mutual fund dealers should be exempt from the NI-81-102 requirement to have separate trust accounts to hold client cash, as there is no such requirement for investment dealers. In addition, the commentator recommended that mutual fund dealers should be allowed to invest client funds to maximize their return and should be permitted to keep any interest earned on clients' funds. The commentator was

of the view that these measures would prevent at least some of the costs of the IPC from being passed down to clients.

MFDA Response

The administration of NI 81-102 is within the jurisdiction of the CSA Members and not MFDA or IPC. The ability of MFDA members to hold cash other than in a trust account materially increases the risk to IPC and matters of fund size, amount of assessments and other issues that will be reviewed by the Working Group would require consideration if cash is available to be used in a member's business.