



Advancing Standards™

March 9, 2012

c/o M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Attention: Ms. Beaudoin

Re: Notice and Request for Comment regarding compensation of consumers of financial products and services

The Portfolio Management Association of Canada (“PMAC”, formerly the Investment Counsel Association of Canada (ICAC)), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to submit the following comments regarding the *Autorité des marchés financiers* (“AMF”) Notice and Request for Comment regarding compensation of consumers of financial products and services (the “Notice”) published on December 9, 2011.

As background, PMAC represents investment management firms registered to do business in Canada as portfolio managers. In addition to this primary registration, some firms will be dually registered as exempt market dealers or other registration categories but generally 70% of their income is derived from portfolio manager registration to be members of PMAC. PMAC was established in 1952 and currently represents approximately 160 investment management firms that manage total assets in excess of \$800 billion (excluding mutual funds assets). Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

PMAC supports the AMF's review of the compensation of victims of financial crime and how the *Fonds d'indemnisation des services financiers* (the “Compensation Fund”) should operate.

General Comments

PMAC endorses initiatives that strengthen investor protection and we support the objectives outlined in the Notice. In assessing the effectiveness of the existing compensation mechanisms in Quebec, we believe that the AMF should carefully consider existing protection mechanisms, and in particular, those currently in place for investment fund managers and portfolio managers.

PMAC understands that a part of the AMF's consultation process on its Compensation Fund is to reflect on the different approach used in Québec with a view to harmonizing it with the practices observed in the rest of Canada. While much progress has been made by the provinces to try to minimize differences between provincial legislation and/or rules, there continues to be significant differences in regulatory responses to certain issues. The merits of uniform and consistent measures to address investor protection outweigh in our view the perceived value and the practical costs and burden posed on stakeholders from a divergent regulatory and investor protection landscape. We believe that the AMF should harmonize the requirements relating to its Compensation Fund in order to ensure a consistent level of protection to investors regardless of the jurisdiction in which they reside. Such harmonization efforts would not only achieve regulatory consistency but would also increase the level of protection to investors in Quebec since the compensation limits for protection mechanisms in other parts of Canada are generally higher¹ than the amount per claim available to Quebec investors (\$200,000) under the Compensation Fund.

We also believe that if the AMF retains the current form of Compensation Fund, it does not need to extend coverage to all entities registered with the AMF, including investment dealers and fund managers. In our view, the current regulatory requirements for such entities to maintain insurance to cover dishonest or fraudulent acts by employees is sufficient.

The following are our specific comments on certain of the issues and questions contained in the Notice, along with our recommendations.

Issue #1: Role of compensation among measures intended to protect consumers of financial products and services

Recommendation

Bolster fraud prevention and protection measures as a first step in protecting consumers of financial products and services.

¹ For example, the compensation limit under the Canadian Investor Protection Fund (CIPF) and the MFDA Investor Protection Corporation (IPC) is \$1 million. In the U.S., compensation limits are also higher, such as with The Securities Investor Protection Corporation (SIPC), where the maximum compensation recoverable from a failed firm is US\$500,000 per consumer, including a maximum of US\$250,000 for cash claims.

We applaud the AMF's recent efforts in launching its new consumer awareness campaign focusing on five key questions² to help avoid financial ruin. We agree that encouraging consumers to develop sound investment habits by asking themselves key questions is a step in the right direction and in our view, this campaign should be disseminated as broadly as possible. Educating investors on how to avoid fraudulent investment schemes should remain a key priority for Canadian regulators.

We also believe that further emphasis should be placed on the responsibility of individuals to ensure they are dealing with registered representatives. For instance, individuals need to be aware that only registered representatives with the AMF may offer financial products, provide advice and manage investable assets. Individuals should consult the AMF's Registrar of Companies and individuals authorized to practice. While this is available on the AMF's website, the investing public may not be aware of this resource. We note that accessibility to this information is key and promoting this source on the website by increasing its visibility on the site and enhancing its usability would be helpful to the investing public.

Similarly, many of the commissions provide certain registration information about registrants on their websites, including name, registration category, and any terms and conditions, so the public is able to obtain some information at this time. The Canadian Securities Administrators website also provides access to a national registration search which contains the names of all registrants (individuals and firms) in Canada, with the exception of those registered solely with the Ontario Securities Commission (OSC).³ We note that registration conditions for companies and individuals registered in Quebec are not available through the National Registration Search. The AMF should also consider including access to its registrants in the National Registration Search as investor tools need to be made more accessible across the jurisdictions.

PMAC believes that increased focus should be spent on educating consumers of these resources and others, as well as the benefits of dealing with a registered firm and/or individual. We also think consumer education efforts should include information to investors about insurance protection and what questions they should be asking representatives in respect of such coverage.

To further the objective of minimizing incidents of fraud and fraud prevention, the AMF should allocate more resources towards using the tools that are already in place to prevent fraud, such as closing monitoring of current regulations, risk-based examinations or audits. Increasing sanctions and enforcement for misconduct should also be considered. In our view, qualitative and quantitative research and analysis of past fraud involving registrants would help determine where there needs to be improvements made. A greater emphasis on prevention will help reduce incidents of

² (1) Is the person offering the investment registered with the AMF?; (2) Were you given written information and detail on the investment?; (3) Have you ever dangled a return to good to be true?; (4) Have you been or are you being induced to invest?; and (5) Has there been evidence or behaviour that is suspicious?

³ OSC registration information is available on the OSC Registrant List.

fraud and therefore, result in less reliance on indemnification recognizing that insurance coverage still provides a backup solution. We agree with the AMF that compensation is the last defence within a scheme to protect consumers of financial products and services.

Issue #2: Accountability of consumers and representatives

Recommendation

Consumers and representatives should have accountability in avoiding financial fraud.

PMAC believes that the compensation mechanisms in Québec should place greater importance on the accountability of consumers and representatives. As noted in our comments above, there are various investor protection mechanisms in place to ensure that investors are not defrauded. Investors should have some level of accountability in the choices they make based on the information available to them.

Issue 4: Approach with respect to consumer compensation

Recommendation

The AMF should adopt a compensation system like the rest of Canada which is based on the insolvency of firms.

In conjunction with our comments above on the harmonization of the approach used in Québec to compensate victims of fraud with the rest of Canada, we believe that the AMF should adopt a compensation system which is based on the insolvency of firms. A system based on insolvency avoids costly overlaps as it takes into account and relies on other protection mechanisms such as insurance coverage (i.e. E&O) and capital requirements, including new capital requirements for investment fund managers under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103).

In the U.S., we note that the consumer protection system includes an investor protection body that compensates consumers of financial products when a securities dealer is in financial difficulty or insolvent. The U.S. does not have a fraud compensation fund. In our view, the AMF should adopt a compensation plan which is based on insolvency rather than its current compensation scheme as this would increase the level of protection to investors in Quebec since the compensation limits for protection mechanisms in other parts of Canada are generally higher.

Issue 6: Products, representatives and conduct covered by the Compensation Fund

Recommendation

*If the Compensation Fund is maintained, coverage **should not be** extended to all entities registered with the AMF, including investment fund managers and portfolio managers.*

NI 31-103 sets out prescribed requirements for investment fund managers and portfolio managers in respect of maintaining bonding or insurance. We believe these requirements provide the necessary coverage to manage instances involving fraud. Enhanced reliance on insurance coverage as a means to fraud protection ensures that consumers are afforded the same protection regardless of the jurisdiction in which they reside. In our view, there is no need to extend coverage in the Compensation Fund to these entities as adequate coverage is already in place through regulatory requirements. We also note that there is superior protection to investors under these insurance schemes than that afforded under the Compensation Fund.

In this regard, we would also highlight that investor protection was greatly enhanced with the implementation of NI 31-103. The registration process under NI 31-103 is designed to protect the investing public by striving to ensure that only qualified and reputable individuals and firms are licensed. Moreover, NI 31-103 created enhanced proficiency requirements for all registrants and mandatory working capital and insurance requirements for registrant firms. The enhancements to know your client (KYC), know your product (KYP) and suitability requirements have also increased the scope of investor protection in this industry. We believe the harmonization and modernization of NI 31-103 was an immense step in the regulatory landscape of our membership and provides a sufficient level of protection to investors who chose to use portfolio managers to manage their investments.

In addition, we note that portfolio managers (in all provinces other than Quebec) are subject to a mandatory requirement to offer dispute resolution services⁴ to their clients and must participate in a complaint handling process. In our view, this requirement under NI 31-103 and similar requirements in sections 168.1 to 168.1.3 of the Quebec *Securities Act* are effective tools to foster investor protection and should work to decrease the incidences of fraud and claims made under the Compensation Fund.⁵

⁴ As of September 28, 2012, see s.13.16 of NI 31-103. In Québec, a registered firm is deemed to comply with Division 5 of NI 31-103 if it complies with sections 168.1.1 to 168.1.3 of the *Securities Act* (Québec).

⁵ The MFDA and IIROC have similar complaint management requirements.

Conclusion

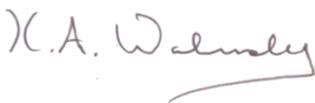
PMAC believes that Investor protection can be achieved through various existing measures in place and any efforts by the AMF to revisit its Compensation Fund program should be aimed at harmonizing its practices with those in the rest of Canada. We also believe that regulators should prioritize fraud prevention as well as investor education programs. Our key recommendations are:

- *Bolster fraud prevention and protection measures as a first step in protecting consumers of financial products and services.*
- *Consumers and representatives should have accountability in avoiding financial fraud.*
- *The AMF should adopt a compensation system like the rest of Canada which is based on the insolvency of firms .*
- *If the Compensation Fund is maintained, coverage should not be extended to all entities registered with the AMF, including investment fund managers and portfolio managers.*

PMAC endorses the efforts of the AMF to undertake a review of the Compensation Fund and we would be pleased to participate in any further consultation process the AMF undertakes. If you have any questions regarding the comments set out above, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Julie Cordeiro at (416) 504-1118.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



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