



***Via E-mail***

March 9, 2012

Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22nd Floor  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Dear Ms. Beaudoin

**Re: Notice and Request for Comment Regarding Compensation of Consumers of Financial Products and Services**

This comment letter is being submitted on behalf of the following entities: RBC Dominion Securities Inc. and RBC Direct Investing Inc. (registered investment dealers); Royal Mutual Funds Inc. and Phillips, Hager & North Investment Funds Ltd. (registered mutual fund dealers); RBC Global Asset Management Inc. (registered investment fund manager, portfolio manager and exempt market dealer); RBC Phillips, Hager & North Investment Counsel Inc. (registered portfolio manager) (collectively "RBC"). We are writing in response to the Autorité des marchés financiers' ("AMF") request for comment on the *Consultation Regarding Compensation of Consumers of Financial Products and Services* (the "Consultation Paper") published on December 9th, 2011. We appreciate the opportunity to provide comments to the AMF on the role of compensation in the financial services industry.

## **GENERAL COMMENTS**

RBC fully supports initiatives which strengthen investor protection and ensure a fair and equitable framework for all industry participants. Furthermore, we support the objectives outlined in the Consultation Paper to seek input from industry participants on the structure and operation of the *Fonds d'indemnisation des services financiers* ("Compensation Fund"). In assessing the current structure of the Compensation Fund, we believe that it is critical that the AMF ensure that the Compensation Fund does not duplicate existing protection mechanisms, particularly those currently in place for investment dealers, mutual fund dealers, investment fund managers and portfolio managers.

In previous comment letters to the Canadian Securities Administrators ("CSA") and AMF, RBC has strongly supported the need to harmonize registration requirements across Canada. To that end, we would like to take this opportunity to reiterate the comments we raised in a November 29, 2010 letter to the AMF in response to the AMF's consultation on the

*Harmonization of Mutual Fund Distribution Regulations*, specifically in relation to the recognition of the Mutual Fund Dealers Association (MFDA) in Quebec. The lack of fully harmonized requirements continues to create significant challenges and additional costs for registered firms that deal both in Quebec and outside of the province. That being said, we believe that it is important that the AMF harmonize their requirements as it relates to the Compensation Fund in order to ensure a consistent level of protection to investors regardless of their jurisdiction. The Investor Protection Fund (IPC) offers protection to investors caused by the insolvency of an MFDA member.

## **RESPONSES TO THE QUESTIONS IN THE CONSULTATION PAPER:**

The following is our response to the questions raised in the Consultation Paper.

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

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

We believe that regulators should focus on fraud prevention by educating consumers of the benefits of dealing with a registered firm and/or individual. The CSA implemented the “National Registration Search” which provides investors with information to confirm the status of the advisor and firm’s registration. The CSA also maintains a disciplined persons list that reveals the names of all persons disciplined by the various securities regulatory authorities and self-regulatory organizations, a key resource in assisting the public in conducting due diligence. In addition, the Investment Industry Regulatory Organization of Canada (IIROC) introduced the *AdvisorReport* which provides investors with access to their advisor’s educational background, registration category and their disciplinary history, if any. With an objective to minimize incidents of fraud, we believe that the AMF should devote resources to promote the tools that are available to investors and the advantages of dealing with a registered firm.

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

We do not believe that it is possible, without a significant cost to the industry and ultimately consumers, to implement a solution which solely relies on an indemnification fund to protect consumers against incidents of fraud. As mentioned above, we are of the view that the emphasis should be placed on prevention in order to reduce incidents of fraud. In addition to educating consumers, we believe that regulators can strengthen regulations to prevent fraud, such as increasing capital requirements for certain types of registrants, risk-based examinations or audits to increase early detection of misconduct, and increasing sanctions for misconduct.

### **Issue 2: Accountability of consumers and representatives**

*Question 3: Do consumers have a certain responsibility to avoid financial fraud?*

Yes, we do believe that consumers should have a responsibility to avoid fraud. Based on the resources currently available to consumers, such as the “National Registration Search”, the CSA disciplined persons list and IIROC’s *AdvisorReport*, we believe that consumers have sufficient resources to conduct due diligence and ensure that they are working with a registered firm or advisor before conducting any business with that firm or advisor.

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

Refer to our response in Question 3.

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

We believe that accessibility to any indemnity fund is a privilege and not a right. If a consumer disregards securities law or knowingly makes an illegal investment, then the consumer should not be granted the right to be compensated under the Compensation Fund.

### **Issue 3: Fundamental objective of a compensation system**

*Question 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?*

In our view, the maximum level of compensation should be the same for all consumers regardless of their financial resources.

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

Before a decision is made to increase or decrease the maximum compensation levels, we believe that the AMF should conduct a cost benefit analysis to determine whether the current Compensation Fund provides the necessary protection to consumers. The Consultation Paper's Reference Guide indicates that the Compensation Fund experienced a significant deficit as a result of increased compensation payments to consumers between fiscal 2003-04 and 2007-08. In order to reestablish the Compensation Fund's financial position, contribution fees for market participants were increased. We believe that a compensation fund, whether it is based on insolvency or fraud, should have certain predictability to the dues payable under the fund regardless of the number of claims.

As mentioned in our "General Comments", we believe that adopting the IPC in Quebec, in addition to recognizing the MFDA, would reduce the regulatory burden for many mutual fund dealers who operate in Quebec and in other jurisdictions.

### **Issue 4: Approach with respect to consumer compensation**

*Question 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 mentioned above under our "General Comments", we believe that the AMF should consider harmonizing requirements with the other jurisdictions which includes recognizing the MFDA. In addition, we take note that the AMF has acknowledged that mutual fund dealers in Quebec and elsewhere would benefit from a single compliance

system applicable in all jurisdictions<sup>1</sup>. We believe that this extends to adopting the compensation model which is currently in place in the other jurisdictions, such as the IPC for mutual fund dealers. In the case of investment fund managers and portfolio managers, we believe that the Financial Institution Bond (FIB) provides the necessary coverage to manage instances involving fraud. We believe that this type of approach would ensure that consumers would be afforded the same protection regardless of the jurisdiction in which they reside. To that end, the AMF should adopt a compensation plan which is based on insolvency rather than the current compensation scheme.

*Question 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?*

Further to our response in Question 8, 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 mechanism such as the FIB and other insurance coverage (such as E&O); capital requirements, including new capital requirements for investment fund managers under NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI-31-103); a strong industry complaint resolution process; and, as a last resort, a solvency based compensation fund.

In addition to the above, the AMF could consider introducing a risk-adjusted capital requirement for firms. Currently, IIROC evaluates material from a Dealer Member firm's monthly and yearly reports which is used to calculate the Dealer Member's Risk Adjusted Capital (RAC). Based on IIROC's requirements, if the firm becomes capital deficient, meaning its RAC drops below an acceptable level, the firm is required to remedy its RAC or face immediate suspension if there is any likelihood of financial loss to the public. This serves as an early warning system in order to detect the likelihood of insolvency of a Dealer Member.

## **Issue 5: Responsibility for managing mechanisms intended to compensate victims of financial crime**

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

We do not believe that we have sufficient information at this time to comment on the governance of the Compensation Fund.

*Question 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?*

As stated previously, we believe that a system based on insolvency is a better approach. The IPC and the Canadian Investor Protection Fund (CIPF) have the necessary policies and procedures and governance structure to determine the eligibility of claims.

*Question 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?*

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<sup>1</sup> Consultation on the *Harmonization of Mutual Fund Distribution Regulations*, dated October 1, 2010

In general, there needs to be greater clarity for consumers in understanding what options are available to them when resolving disputes with a dealer or advisor. In our view, considerable efforts have been made by industry participants to implement a dispute resolution or mediation program to manage complaints as required under NI 31-103 and sections 168.1 to 168.1.3 of the Quebec *Securities Act*. We believe that an effective complaint handling process should limit the number of fraudulent cases being put forward under the Compensation Fund. Furthermore, the MFDA and IIROC require that firms implement a branch review program which includes both the review of trading patterns and the management of complaints. The branch review program is also an effective measure in preventing fraud.

*Question 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?*

Currently, insurance companies have their own protection mechanisms for consumers, namely Assuris and The Property and Casualty Insurance Compensation Corporation. In addition, investment fund managers, portfolio managers and investment dealers and mutual fund dealers (outside of Quebec) are required to maintain coverage in the form of a FIB which covers losses through any dishonest or fraudulent act by an employee of the firm. Furthermore, mutual fund dealers and investment dealers contribute to the IPC and the CIPF compensation funds. We believe that a single compensation fund to cover several types of financial services is neither fair nor practicable. As an example, the mutual fund industry would be financing a compensation fund that covers insurance company insolvencies and vice versa. To that end, we believe that if an entity is involved in both the securities and insurance industry, then they should contribute to each industry's respective compensation fund.

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

*Question 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?*

Refer to our response in Question 13.

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

Further to our response in Question 13, we do not agree with extending the coverage of the Compensation Fund to all entities registered with the AMF. As stated above, investment dealers, portfolio managers and investment fund managers are required to maintain a Financial FIB which covers dishonest or fraudulent acts by employees. In addition, investment dealers are also required to contribute to the CIPF and mutual fund dealers registered with the MFDA are required to contribute to the IPC. We do not believe that the AMF should require investment dealers or mutual fund dealers to contribute to two or more compensation funds.

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

Further to our comments above, we believe that the AMF should adopt a system which is based on insolvency.

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

No, errors and omissions are already covered by the professional liability insurance requirement. When assessing the structure of the Compensation Fund, we believe that the AMF needs to be mindful to avoid duplicative coverage given that industry participants must cover the cost of premiums and/or participation fees.

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

Refer to our response in question 17.

### **Issue 7: Funding the Compensation Fund and cost containment measures**

*Question 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?*

Further to our response to Question 1, we believe that it is important for regulators to prioritize fraud prevention as well as investor education programs.

*Question 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?*

Refer to our response in Question 9.

*Question 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?*

As mentioned above, we believe that the AMF should adopt an insolvency model. However, if the AMF decides to keep the current Compensation Fund as it is, we recommend that the AMF consider obtaining insurance coverage similar to the CIPF.

### **Concluding Remarks**

Thank you for providing us with the opportunity to provide our comments. We would be pleased to discuss our comments further with you. If you have any questions or require further information, please do not hesitate to contact the undersigned.

Sincerely,

*“David Agnew”*  
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