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Anne-Marie Beaudoin,
Attorney Secretary General
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Stock Exchange Tower
Montreal, Quebec H4Z 1G3

Dear Ms Beaudoin:

Re: Quebec Compensation Fund – Quadrus Submission

We are writing in response to the request for comments set out in the Consultation Paper issued by the Autorité des marchés financiers (AMF) in November, 2011 regarding the Compensation of Québec Consumers of Financial Products and Services.

Quadrus Investment Services Ltd. is one of the largest mutual fund dealers in Canada with over 3,700 registered investment representatives. Quadrus is a member of the Great-West Lifeco Inc. group of companies, which includes The Great-West Life Assurance Company, London Life Insurance Company and The Canada Life Assurance Company. Quadrus has \$7.5 billion in assets under administration, including over \$1.2 billion related specifically to our Quebec based customers.

The enclosed document reflects our responses to the questions posed by the AMF in the Consultation Paper. We have also had the opportunity to review the submission made by Investors Group Inc. and strongly support it.

We very much appreciate the opportunity to share our thoughts with the AMF, and would be pleased to discuss them with you at your convenience.

Sincerely yours,

Michael Stanley
President & CEO
Quadrus Investment Services Ltd.

MS:jw
Enclosure

Request for comment regarding compensation of consumers of financial products and services

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

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

The current Quebec system has done a reasonable job in providing an emphasis on both fraud prevention and victim compensation. We recognize and applaud the creation and evolution of the Education and Good Governance Fund by the AMF, and their ongoing efforts at educating the consumer of financial products in Quebec. No system is perfect and that needs to be acknowledged by all constituents. This consultation paper entertains ideas to improve the system based on perceived shortcomings. The danger that comes with acting on short-term perceptions of the current system is the unintended consequence of introducing unforeseen instability in the Quebec market.

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

A stable system which is functioning reasonably well does not require dramatic changes. Any additional resources should be allocated with the philosophy of “an ounce of prevention is worth a pound of cure”. We believe that more can be gained by bolstering fraud prevention measures than by enhancing the Financial Services Compensation Fund (“Fund”).

We recognize that the AMF has for some time, made information available on their web sites to the public relating to financial literacy, and specifically fraud prevention. The AMF has also reached out to the community (Universities, Legal protection for the elderly against financial exploitation) through awareness campaigns. The public today can verify registrants licensing on the AMF website where they also have access to a variety of education tools. We recommend the AMF direct more energy and resources to the delivery of this type of information and education to the public, through such vehicles as media campaigns, education programs in schools of all levels, and seniors groups through print materials, direct mail and other popular means of communication including social media.

Also, although disciplinary and administrative decisions are published by Quebec regulators it may not be easy for the average consumer to find them. This information should be readily available when enquiring about a person on the AMF Website.

Focus should also be given to early detection of potential fraudulent activity. Risk based audits of registrants and representatives covered by the Fund should be considered. Such audits would focus on sectors and/or registrants with greater potential risk of loss to the Fund.

In cases of fraud, appropriate resources and energy should be put towards prosecution of violators and the imposition of appropriate penalties and fines.

It is always difficult to justify actions by pointing to a fraud that never happened because those actions were taken. However, it is beyond doubt that the costs to society, individuals and financial institutions of avoiding fraud is far less than the cost of dealing with fraud once it has occurred. We believe strongly that money invested in fraud prevention is money well spent.

Issue 2: Accountability of consumers and representatives

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

It is our belief that the primary deterrent of fraud is a knowledgeable consumer. This is why any additional resources should be mainly focused on consumer awareness and education. The introduction of a “Bill of Responsibilities” for the consumer would be of benefit to the citizens of Quebec since it would help articulate the responsibilities of all consumers in:

- Selecting a representative registered with the AMF to aid them by providing knowledge, information and investment recommendations.
- Being aware of the hallmarks of fraudulent schemes, including threats and types of suspicious behavior or abnormal conduct that should raise concerns
- Understanding and choosing their investments;
- Monitoring and rebalancing their investments;

As indicated above, we believe that the key element to this approach is to make it easy for consumers to know that the person they are dealing with is appropriately registered with the AMF, and that their services are thus covered by the Fund. Such information should be readily available on the internet. Consumers should be made aware of these resources, and be told how to access them.

Developing and implementing awareness campaigns and education materials for consumers is best achieved by government authorities who have the credibility to offer independent information.

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

A more knowledgeable consumer will naturally shy away from fraudulent investments thereby lowering demand on the Fund. As such, it would seem that the integrity of the Fund will be aided by ensuring that consumers and registrants are accountable for their

own behavior. Consumers should be expected to be alert to potentially fraudulent schemes and avoid them. Registrants should apply appropriate oversight and diligence to avoid offering fraudulent schemes or illegal investments.

If this fundamental accountability is not imposed consumers would have an incentive to take on greater risks knowing that they will be compensated if the investment turns out to be fraudulent. This behavior change will result in increasing Fund fees and future claim payouts. If clients pursue risky and fraudulent investment schemes instead of legitimate ones, legitimate financial institutions would suffer, thus lowering their ability to contribute to the Fund. Over time, consumer behavior of this nature would lead to ongoing deficits with the final outcome being an unstable Fund which could not be maintained without significant backstopping of funding from the Quebec government.

Past experience indicates significant risk to consumers lies in those purchasing unregistered securities and measures need to be put in place to detect and deal with this risk.

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

A consumer who knowingly makes an illegal investment should lose the right to be compensated in the event of fraud. Any other position could encourage consumers to purchase illegal investments because of the compensation backstop provided in the event the investment turns out to be fraudulent.

We have concerns about the implications to the Quebec government if its agencies support a compensation plan that rewards consumers who knowingly partake in an illegal investment.

However, we do not believe that many investors “knowingly” make illegal investments. We believe that the more likely scenario involves an investor who is presented with something that is “too good to be true”. The investor wants to believe that the large returns promised are legitimate and chooses not to ask any further questions. Such a consumer acts with willful blindness and in doing so is inviting the risk of loss.

We believe that a consumer who fails to determine if the person they are dealing with is a registrant, or who is willfully blind to the nature of the investment and fails to ask simple and appropriate questions that would illuminate the suspect nature of the investment, should not be entitled to compensation from the Fund.

The AMF should consider implementing an “investment hot line” through which investors can ask whether a specific investment proposal they are considering is problematic or suspect. Such an approach would allow the AMF to better monitor and deal with incipient frauds early on, thereby better protecting consumers and lowering the risk of a claim on the Fund.

Issue 3: Fundamental objective of a compensation system

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?

Fraud of any kind is unacceptable regardless of who the victim is. Basing the payment of claims against the Fund on some sort of level of income or means testing indirectly implies that financial fraud is, from a societal perspective, less of an evil if it is incurred by those who are above the line.

In addition, there would be significant complexity that would need to be introduced into the adjudication process before finalizing payouts. There is an inherent danger that this complexity could affect the determination of whether a situation was actually financial fraud or not. We fear a means/income test would cause an inherent bias in the adjudication of potential financial fraud claims. It is our view that all claims need to be reviewed through a consistent framework for the determination of what is financial fraud. Any other approach is not truly even handed and will undermine the overall credibility of the process.

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?

We believe the fundamental objective of the fund is provide some form of coverage (or compensation) for consumers who otherwise are unable to 'insure' their financial portfolio and products against those who would intentionally defraud or embezzle from them.

We believe that a "last dollar" approach is neither practical nor desirable. Any Fund must be structured in such a way as to protect innocent victims without providing a risk-free incentive for investors to pursue perceived "high return" fraudulent investment schemes. Returning 100% of an investment provides a clear incentive to take extraordinary risks. Any losses will not be borne by the consumer or the fraudster at all, but by those in the industry that abide by the rules. We suggest that it is not appropriate for a government to protect its citizens from all possible implications of willfully blind or knowingly harmful decisions, particularly if the cost of that "protection" is borne by persons with limited or no control over the behaviour. As noted in previous responses, consumers have a responsibility to be cautious, alert and reasonably knowledgeable about their investments, and government and industry should provide them with appropriate information to allow them to detect and avoid fraud.

Not only would a 100% coverage system encourage consumers to pursue fraudulent investments, but it could potentially cause some unscrupulous persons to market and attract business as a result of the 100% guarantee in the Quebec market. It would provide a powerful marketing message for fraudsters: "Why not take a shot at this,

as you are covered either way!” A 100% system would in time punish those companies with stronger governance regimes which forbid the marketing of potential fraudulent investment schemes. Such a structure would clearly be to the advantage of firms who have little or no compliance oversight.

We are not aware of any North American jurisdiction that covers the very last dollar for such concerns as insolvency or fraud. Doing so would have a catastrophic effect, as a single or a few large claims could destroy the future viability of any Compensation Fund. An examination of the state which North American Pension Guarantee Funds have found themselves in because of a few large bankruptcy situations is worth noting.

If it is the desire within Quebec to provide last dollar compensation for all financial fraud situations, then this is a benefit that should be borne by all Quebec residents at large. Much financial fraud is perpetrated by unregistered individuals, and thus recovery should not be paid for by other registrants – those who follow the rules. It can be argued that such universal “coverage” is a societal good and so should be funded out of the tax revenues of the province. Structuring a Compensation Fund providing last dollar coverage in all situations which is funded by the industry to cover behavior that is not within the control of the industry will be very costly and unjustifiable. Those firms and representatives who operate primarily in Quebec will be at a disadvantage compared to their peers conducting business throughout the rest of the country because of the levies they need to pay to operate within Quebec.

We believe that the Compensation Fund should maintain the goal of compensating direct losses from fraud subject to a maximum amount of compensation (the ceiling). Such a ceiling should be the same for all claimants regardless of their financial resources. Compensation may be partial or complete according to a factual analysis that takes into account the ceiling and contributory fault and / or the claimant’s responsibility in the decision to invest. We believe that adopting an approach of full compensation without recognition of the fault of the consumer would not favour empowering consumers, representatives and firms.

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

The current \$200,000 level may be reasonable and appropriate but perhaps more research on other measures taken in other jurisdictions may be useful. Consideration may also be given to the possibility of indexing periodically the maximum eligible amount of a claim pursuant to inflation to avoid need for modernization in the future.

We believe that the ongoing viability of the Fund would be improved significantly if a “coinsurance” element was added. Our recommendation is that the Fund limit any compensation payment to 85% of the full claim amount, up to the maximum established. This approach inserts a risk sharing feature between the consumer and the Fund.

As noted in our previous responses, it is the consumer who needs to act as the primary deterrent to financial fraud. Where the consumer chose to pursue an extraordinary return the consumer should make that decision knowing that they are expected to accept at least some of the loss. Education efforts to make consumers aware of their responsibilities are negated if the consumer can expect to get 100% of their money back. Even a sharing in costs of 15% by the consumer and 85% by the Fund will go a long way to ensure the consumer is wary of entering into situations which may be fraudulent. This approach has the added benefit of greatly strengthening the long term viability of the Compensation Fund.

Issue 4: Approach with respect to consumer compensation

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?

Harmonization of compensation approaches for securities and mutual fund dealers across Canada would be a desirable outcome, bearing in mind the unique aspects of Quebec's legal and regulatory system. We recommend that the AMF engage in a comprehensive analysis of the potential impact of harmonization with other Canadian compensation systems on consumers and the industry. This analysis is important in the context of harmonizing the rules in Quebec with those of the MFDA, for example.

Following the AMF's November 2010 consultation on the harmonization of the regulation of the mutual fund industry it became apparent that such action would reduce costs in the mutual fund industry, maintain a single compliance system, and allow for better coordination between regulatory bodies. Above all, this project would enable consumers to benefit from similar protections regardless of the territory in which they deal. It is important to keep in mind that consumers are more mobile than in the past.

We strongly recommend that the AMF focus on participating in a comprehensive system covering a wide territory. To the extent that the rules of the MFDA are eventually integrated into the Quebec landscape, the Investor Protection Corporation (IPC) should be looked at as the investor protection fund in Quebec. We understand that the coverage provided by the IPC applies in case of insolvency, but several studies have been done by the MFDA on the extent of coverage and the necessary funding to ensure sustainability comparable to similar systems in other industries (see bulletin # 0286 and # 0437 MFDA).

National Instrument 31-103 was introduced with the intent of registration harmonization across Canada, and Quebec participated. This common registration model requires dealer registrants to carry minimum E&O and bonding insurance to cover against liability for negligence and fraud. This coverage should be the first line of protection for consumers with valid claims against registrants.

We acknowledge that the AMF is responsible for overseeing insurance firms in Quebec, and that the Fund is intended to cover those firms as well. We express no opinion with

respect to how the Fund should operate with respect to those firms, but we do suggest that where there is a clear, existing regime for the securities industry outside of Quebec, harmonization with that regime would be appropriate.

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?

We believe that securities firms should have the primary responsibility to compensate the public for any injuries caused by the behavior of the firm or its representatives. Securities firms should have sufficient insurance and bonding to cover for such potential liabilities, whether they arise from negligence or fraud. This currently includes mandated minimum E&O coverage and financial institution bonds as required by National Instrument 31-103, which already applies in Quebec. The public would normally be covered while the firm remains solvent, and Fund based compensation would only be necessary should the firm become insolvent. As such, we are of the view that a system that comes into play only when the securities firm becomes insolvent, in conjunction with adequate insurance and bonding coverage, would be a better solution. It would spread the potential cost of losses over more than one funding vehicle and premiums would better reflect the relative risk each firm poses to the system as a whole.

A single Fund runs the risk of moral hazard – well run, disciplined firms will end up paying the costs to protect clients from firms and individuals that prefer to run risks, offer inappropriate products and mislead clients. We do not believe that this is the right structure to deter inappropriate behavior, and would appear to penalize good firms for the behavior of bad ones.

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

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

We believe that the current governance of the Fund should be re-examined. The current structure presents real and apparent potential conflicts of interest. The current model provides that the AMF receives, investigates, adjudicates and pays out on complaints, then proceeds to recover the payment from the affected firm. Furthermore, proceeds of administrative penalties imposed on entities through the laws and regulations under its jurisdiction partly finance the Fund. The AMF is also potentially placed in the position where it may be subject to direct liabilities. Having potential access to the Fund to pay such liabilities even if they are not related to the risks covered by the Fund would be inappropriate. Even the appearance of such a possibility would be dangerous to the administration of regulation in the Province, and the risk should be avoided wherever possible.

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?

It may be appropriate to adjudicate on claims against and payments from the Fund through an independent body. This would avoid the situation where the AMF adjudicates on the outcome of its own investigation, with all the conflicts of interest inherent in such a situation. This is the model successfully followed in the MFDA's Investor Protection Fund, and the life insurance companies Assuris model, for example.

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?

The insurance industry recommends a tribunal or similar functioning independent entity with its own governance would be more suitable. Such an approach may not be less complex and would carry associated expenses; however, it would eliminate any real and apparent conflicts of interest.

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?

Such an approach may be suitable, provided that it was limited to dealing with fraud arising from the sale and marketing of products issued by those entities that support the Fund.

If such an approach were to be considered, we believe that the fee structure should be moved to a risk based approach. It is entirely possible that one arm of financial services would give rise to more risk of loss to the Fund than another arm, and we do not believe that it is appropriate for the same fee to apply to both participants. For example, if experience shows that claims are higher in a particular sector of the financial services industry, participating firms and/or registrants in that sector should be assessed appropriately higher fees, as an incentive to improve oversight practices.

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

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?

It is reasonable to require investors in Quebec to take responsibility for ensuring that they are dealing with a registrant of the AMF provided they are given adequate tools and information to do so.

If an investor suffers from investment fraud as a result of dealing with an individual who is not licensed with the AMF, then that situation should not be handled through the Fund. The courts are the method through which this investor would seek redress.

If when dealing with a registrant of the AMF (regardless of what capacity they are registered), an investor suffers fraud as a result of the registrant then that conduct should be covered by the Compensation Fund. The exception to this would be if the investor knowingly participated in an illegal investment or is willfully blind to it (see answer to question 5).

This is an area where education efforts around fraud prevention could be bolstered. Specifically, communicating to investors that they have a responsibility to ensure they are conducting business only through licensed registrants of the AMF and guiding them to existing means by which they can easily call or go online to be certain that the individual that they are working with is licensed with the AMF.

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

We support such a move, provided that the Fund is administered by separately funding claims arising from different sectors. This would ensure that low risk sectors are not funding liabilities arising from high risk sectors.

A risk based approach allows for a separation of premium levies between dealers, fund managers, insurance firms and representatives themselves. This would lead towards a charge as a percentage of assets based on a risk matrix. A levy of this type seems more equitable than a flat amount per registrant which would overcharge those registrants doing a small amount of business or less risky business and undercharge those with higher risks which would foster a greater risk appetite. The key in any risk based approach is to ensure that there is no overlapping/overcharging as the same dollar of asset can be found under the fund manager, investment dealer, firms and representative.

A risk based approach would allow the Fund to better adjust its funding to the causes of loss, lowering the risk of having registrants with high standards of behavior and oversight paying the freight for those with lower standards.

Similarly, each category should be responsible for oversight of those matters that come within their control. This is a far more equitable approach. For example, if there is an increased incidence of representatives selling fraudulent investments that their dealer prohibits then it should be the representatives' premiums that are raised and not that of dealers. Similarly if at some point, fund managers are found to be engaging in significant fraudulent behavior, then it should not be the dealers or representatives which are charged for this.

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

The current coverage is sufficient.

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

We feel the current mandate of the Fund, to cover willful acts such as fraud, fraudulent tactics and embezzlement is appropriate.

It is important to avoid duplication with existing coverage such as professional liability coverage which covers errors and omissions.

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

The implication of overlapping compensation programs and liability plans is that it burdens stakeholders with added costs that are not present in other jurisdictions. This is inefficient and creates potential conflicts over which coverage should pay first. In the end it is the Quebec consumer that pays for this inefficiency either through costs passed on to them or through less competition in the financial industry of the province.

In addition, any expansion of coverage potentially undermines the long term stability of the Fund. It creates greater complexity in the adjudication of claims and requires more staff for the increased administration. All of this costs money and in the long run it could potentially undermine the long term stability of the Fund.

Yes, measures must be taken to avoid duplication. Refer to responses to questions 16 and 17 above.

Issue 7: Funding the Compensation Fund and cost containment measures

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?

The Fund would benefit from a careful rebalancing on a number of different aspects with a view to lowering the risk of catastrophic loss and excessive claims on the viability of the Fund. As noted in our comments, the mere existence of the Fund as a backstop could have the unintended consequence of creating incentives for consumers to take inappropriate risks at the expense of others.

As we've mentioned previously, we support the following actions:

- Assessments should be risk based such as a percentage of assets based on a risk matrix (see response to #15)
- The maximum reimbursement amount of \$200,000 should be retained unless otherwise indicated by research, and should be indexed to inflation
- A coinsurance level of 85% on any payouts should be applied (see our response to question 7);
- Any registrant to be covered under the Fund should pay into it;
- For securities purposes, the Fund should be harmonized with securities based funds in Canada, and should be limited to claims against registrants that are insolvent;
- The administration of the Fund should be undertaken by a body independent of the AMF;
- Direct new energy and resources to delivering consumer awareness and education to aid in the detection and avoidance of fraud

20. What can be the impact, for Quebec investors, in relation to the availability and the quality of the financial products; on the level of expected returns, on the level of risk tolerance and regarding the capacity for diversification?

If the cost to carry on a particular business in Quebec exceeds that of doing so in other jurisdictions because of the costs of participating in the Fund, there is always a potential for an impact on Quebec consumers. If registrants believe that the Fund support structure is inequitable (good firms are paying a premium to allow bad firms or individuals to sell fraudulent products) and consumers perceive a risk-free way to pursue high returns and therefore avoid more appropriate products offered by good firms, those good firms may find the returns not worth the cost.

It is difficult to measure the direct impact on investors. An increase in total costs for the creation and distribution of a financial product will likely have an impact (sometimes direct, sometimes indirect) on consumers which could result in a decrease in the financial performance of the product or even the availability of it (if the costs make the product non-competitive with respect to similar products).

21. 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?

We have mentioned a number of these opportunities in our previous responses. See #19.

22. 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?

We understand that currently dues paid by the industry are intended to cover the Fund's current needs, and there are no reserves. It seems prudent that some form of contingency is available in the event of a major fraud.

Contributions to the Fund should remain level if no payout from the Fund is incurred. In the event of a payout, fees should increase proportionately, on a risk based approach, to build up the Fund and reserves. High risk sectors, or sectors that have experienced high claims, should bear a higher proportion of the costs than those with low risk or little or no claims history.