CANADIAN INVESTOR PROTECTION FUND
THE INDEPENDENCE OF COMPENSATION FUNDS
MARCH 31, 2021

INTRODUCTION

In late 2019, the Canadian Securities Administrators (the "**CSA**") initiated a review of the regulatory framework[1] for the Investment Industry Regulatory Organization of Canada ("**IIROC**") and the Mutual Fund Dealers Association of Canada (the "**MFDA**"). In CIPF's view, one of the principal goals of the review is to address the question of how best to improve the efficiency and effectiveness, while reducing the regulatory burden, of Canada's securities regulatory framework in light of transformative changes in the Canadian securities industry.

The review prompted the MFDA to publish a proposal for a single modern self-regulatory organization ("**SRO**") in February 2020. IIROC subsequently published a proposal in June 2020 advocating for the consolidation of IIROC and the MFDA.

During this period of regulatory reflection, an important question becomes how the industry compensation funds ought to fit within the new regime. **This paper considers whether the Canadian Investor Protection Fund ("CIPF") should remain an independent body or be integrated within a future SRO.**

EXECUTIVE SUMMARY

Both CIPF's and IIROC's guiding principles focus on public interest and investor protection. However, their missions differ. CIPF's mandate is limited to providing protection, on a discretionary basis, within prescribed limits to eligible customers of IIROC members suffering losses as a result of the insolvency of a CIPF member. Conversely, IIROC's mandate, which serves to shape its regulatory role, includes the objectives of investor protection, market integrity, capital market efficiency and competition.

CIPF is an integral component of the securities regulatory framework in Canada, supporting the stability of the capital markets in Canada. These objectives are best achieved by maintaining the independence of CIPF so that it may fulfil its mandate without undue influence or regard to considerations outside its mandate. It is imperative that CIPF both remain solvent and financially robust and continue to instill investor confidence.

While there are potential benefits to be derived from a consolidation, these are primarily associated with resource efficiencies and reduction in regulatory burden, as well as enhanced regulatory alignment and collaboration. These objectives can be achieved by other means. There are mechanisms currently in place to foster coordination and reduce regulatory burden, which could be improved by introducing enhanced methods of information-sharing, outsourcing and resource allocation among participants in the regulatory framework. In our view, the tension that exists between a regulator and compensation fund is both natural and desirable for the efficient and effective protection of investors and for the stability of Canadian capital markets more generally.

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[1] See CSA Consultation Paper 25-402 – *Consultation on the Self-Regulatory Organization Framework*.

BACKGROUND

In Canada, the regulatory framework of the securities industry consists of CSA members, IIROC, CIPF, the MFDA, the MFDA Investor Protection Corporation ("**IPC**"), the Chambre de la sécurité financière· (the "**CSF**") and the Fonds d'indemnisation des services financiers (the "**FSCF**"). The organization and mandate of each is described below.

Canadian Securities Administrators

The CSA is an umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets.

Members of the CSA have historically relied on SROs to assist them in fulfilling their mandates. Each SRO is typically delegated authority by, accountable to, and subject to supervision by, CSA members pursuant to recognition orders granted by them. Currently, investment dealers are required to be members of IIROC and CIPF, while mutual fund dealers are required to be members of the MFDA and IPC (other than in Québec)[2].

Investment Industry Regulatory Organization of Canada

IIROC is a national self-regulatory organization that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. It is recognized by, and subject to the oversight of, the CSA. IIROC was created in 2008 through the consolidation of the Investment Dealers Association of Canada and Market Regulation Services Inc. Like CIPF, it is incorporated as a non-profit corporation and is funded by the dealer firms and marketplaces that it regulates. IIROC has the broad responsibility to maintain fair and orderly markets and to regulate all securities-related commerce. IIROC must regulate to serve the public interest in protecting investors and market integrity. IIROC carries out its regulatory responsibilities by setting and enforcing rules regarding the proficiency, business and financial conduct of dealer firms and their registered representatives, as well as by establishing market integrity rules regarding trading activity on Canadian equity marketplaces.

Canadian Investor Protection Fund

CIPF is a privately-administered compensation fund that is subject to the oversight of the CSA. CIPF[3] was established as a trust by an Agreement and Declaration of Trust in 1969. Since 2002, it has operated as a non-profit corporation under the *Canada Not-for-profit Corporations Act*. It is funded by its members. CIPF's mandate is to provide protection on a discretionary basis within prescribed limits to eligible customers of IIROC members suffering losses as a result of the insolvency of a CIPF member. The loss must be in respect of a claim for the failure of the member to return or account for securities, cash balances or other property held by such member for the customer as at the date of the insolvency. In connection with such coverage, CIPF engages in risk management activities to minimize the likelihood of such losses.

It is worth noting that the regulatory burden borne by members of CIPF and IIROC was reduced in 2008 by removing from CIPF's mandate the regulatory oversight role previously delegated to CIPF in respect of its member firms. This change was driven largely by a desire to improve

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[2] See below at "Background – *Mutual Fund Dealers Association of Canada*".

[3] Then named the National Contingency Fund.

the efficiency of the regulatory system by reducing duplication in the oversight of regulated entities by the CSA, CIPF and the Investment Dealers Association of Canada (IIROC's predecessor). Currently, the single requirement applicable to member firms that is uniquely required by CIPF is the annual Statement of Member Assets by Location. As a result, the extent of duplication in the existing compliance and reporting obligations for member firms is modest.

Mutual Fund Dealers Association of Canada

The MFDA was established in mid-1998 as an initiative of the CSA to regulate and supervise mutual fund dealers and their representatives. Its members are mutual fund dealers that are registered with provincial securities regulatory authorities. The MFDA is recognized as an SRO in eight Canadian provinces and is structured as a not-for-profit corporation.[4] The MFDA has also entered into a co-operative agreement with the Autorité des marchés financiers (the "**AMF**") to facilitate information-sharing and supervision of MFDA members operating in Québec, and actively participates in the regulation of mutual fund dealers in Québec.

Chambre de la sécurité financière

In Québec, the AMF directly regulates mutual fund dealers operating exclusively in Québec and those mutual fund dealers must be members of the CSF. The CSF is a statutory SRO established in 1999, under the direct supervision of the AMF, that oversees the business ethics and professional development of its members, and also maintains discipline of its members.

MFDA Investor Protection Corporation

IPC is a not-for-profit corporation established by the MFDA to protect client assets held by an MFDA member from an eligible loss in the event that the MFDA member firm becomes insolvent.[5] IPC began offering coverage in mid-2005. It is privately-administered and provides coverage for assets entrusted to mutual fund dealers for investment purposes, which is analogous to the protection afforded by CIPF in relation to investment dealer insolvency. IPC is subject to regulatory oversight by the CSA.

Fonds d'indemnisation des services financiers

The FSCF was created by *la Loi sur la distribution de produits et services financiers* (Québec) in 1999. The FSCF is administered by the AMF and funded by its members. It is a fund designed to compensate victims of fraud, fraudulent tactics or embezzlement for which members (including mutual fund dealers operating exclusively in Québec) or their representatives are responsible.

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[4] The MFDA is recognized by the securities regulatory authorities of Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan. Recognition of the MFDA by the securities regulatory authority in Newfoundland is pending.

[5] Losses eligible for coverage by IPC must arise from the failure of the member to return or account for property of the customer held by or in the control of the insolvent member. Losses that do not result from the insolvency of a member, such as losses from changing market values of securities, unsuitable investments or the default of an issuer of securities are not covered. This is analogous to the criteria for CIPF coverage eligibility.

DISCUSSION

The merits of the debate as to CIPF's role and position within the evolving Canadian regulatory framework are best explored by comparing and contrasting the structures and organization of a number of compensation funds around the world: (i) the Securities Investor Protection Corporation ("**SIPC**") in the U.S.; (ii) the Canada Deposit Insurance Corporation ("**CDIC**") in Canada; (iii) the Deposit Insurance Reserve Fund ("**DIRF**") in Ontario; (iv) the FSCF in Québec; and (v) the Financial Services Compensation Scheme Ltd. (the "**FSCS**") in the U.K.

A number of the compensation funds identified have favoured independence, while others have been integrated within the structure of the relevant regulatory authority. The experiences and deliberations of each are valuable in assessing the value of their approach.

Independence

SIPC in the U.S., the FSCS in the U.K. and the CDIC in Canada have each preserved their independence within their respective regulatory frameworks.

Securities Investor Protection Corporation

The relationship between the Financial Industry Regulatory Authority ("**FINRA**") and SIPC in the U.S. is comparable to that of IIROC and CIPF. FINRA is an SRO established as a not-for-profit corporation, authorized by Congress to regulate member brokerage firms and exchange markets and funded primarily by member assessments. SIPC is a federally created non-profit corporation under the *Securities Investor Protection Act* ("**SIPA**"). Membership in SIPC is mandatory for firms registered with the U.S. Securities & Exchange Commission (the "**SEC**") in certain categories, including mutual fund distributors.[6] Like CIPF, SIPC is an investor protection body that participates in the liquidation of, and compensates consumers of financial products of, a securities dealer upon its insolvency. Both FINRA and SIPC are independent entities overseen by the SEC. No representative of FINRA serves on the board of SIPC.[7]

A high profile dispute between the SEC and SIPC in connection with a Ponzi scheme authored by Robert Stanford serves to illustrate the potential risk in consolidating an investor compensation fund with a regulatory body operating under a broader mandate. At the root of the dispute were questions as to the scope of SIPC's coverage and authority to initiate liquidation proceedings in respect of one of its insolvent members.

In 2009, the SEC brought a civil enforcement action against Robert Stanford, the Stanford International Bank, Ltd. ("**SIBL**") and the Stanford Group Company ("**SGC**") in connection with the sale of over US$7 billion worth of purported certificates of deposits ("**CD**") issued by SIBL, a private bank domiciled in Antigua. The CDs were sold by representatives of SGC, a broker-dealer that was registered with the SEC and was a member of SIPC.

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[6] SIPC is funded by member assessments and interest on investments in U.S. government securities.

[7] SIPC does not have the power or authority to monitor its members for signs of distress. Only the SEC and the SROs can monitor broker dealers, and the initiation of a SIPC liquidation effectively requires a request from the SEC or an SRO. SIPC does not impose any financial requirements or prescribe any practices, nor may it conduct examinations of its members. SIPC is empowered only to react to failures or impending failures, and only when notified by the SEC or an SRO.

The critical question facing the D.C. Circuit Court (the "**Court**") was whether the purchasers of CDs were "customers" for the purposes of SIPA such that SIPC's coverage should be extended to them. The SEC argued that funds deposited with SIBL should be viewed as deposits with the SGC, thereby bringing the purchasers within the definition of "customers". SIPC contended that, despite the interrelation of the Stanford entities, the purchasers were not "customers" entitled to coverage as SGC never physically possessed the customers' funds.

The Court rejected the SEC's reasoning and ultimately held that the purchasers of CDs were not "customers" within the meaning of SIPA.[8] The Court observed that the "principal purpose of SIPA is to protect investors against financial losses arising from the insolvency of their brokers" and that the "critical aspect of the 'customer' definition is the entrustment of cash or securities to the broker-dealer for the purposes of trading securities".[9] Based on the irrefutable factual finding that the investors did not deposit cash with the SGC, the Court determined that SGC never had custody over the purchasers' cash or securities. Accordingly, the purchasers did not qualify as "customers" under the statutory definition.

The Securities Industry and Financial Markets Association ("**SIFMA**") submitted a brief to the United States Court of Appeals for the District of Columbia Circuit in the Stanford case. In August 2011, it also issued a white paper *(Limits of SIPC Protection)* commenting upon the SEC's position in relation to the Stanford case. In both the brief and the white paper, SIFMA characterized the SEC's broad interpretation of SIPA as an effort to override intentional limits imposed by Congress.

On the issue of SIPC's exclusive authority to initiate the liquidation of a member, SIFMA observed that Congress intentionally left the decision of whether to commence a SIPA liquidation to SIPC and not to the SEC. SIFMA found the Court's decision that the SEC could not replace SIPC's judgment[10] to be consistent with public policy considerations. By affording SIPC, an independently funded body, exclusive authority to initiate liquidation proceedings, Congress had successfully insulated the decision from political pressures.

On the question of SIPC's scope of coverage, SIFMA argued that the SEC's reasoning was fundamentally inconsistent with SIPA's narrow mandate (namely, to protect investors from the risk of losing assets entrusted to a broker-dealer upon its insolvency, rather than losses in the value of their investments caused by securities fraud). If the SEC's reasoning were endorsed, it would lead to an unprecedented expansion of SIPA protection that could eventually threaten the solvency of SIPC.

Financial Services Compensation Scheme Ltd.

In the U.K., FSCS administers the compensation fund which provides bank deposit protection as well as protection in respect of financial products such as investments, pensions, insurance and mortgages. FSCS is funded by firm levies, but it has the ability to borrow from the National Loans Fund maintained by HM Treasury. FSCS is independent from both the

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[8] *SEC v. Securities Investor Protection Corp.*, No. 12-5286 (D.C. Cir. 2014).

[9] *Ibid*, pages 11 – 12.

[10] Other than upon a breach of statutory obligations by SIPC.

Prudential Regulatory Authority (the "**PRA**") and the Financial Conduct Authority (the "**FCA**") in the U.K.[11]

While the FSCS is structured as an independent body retaining discretion and operational independence, mechanisms have been implemented to ensure that the FSCS works effectively with the PRA and FCA. Under the *Financial Services & Markets Act 2000* (U.K.) ("**FSMA**"), the FSCS and each of the regulators must cooperate with each other to carry out their respective functions.[12] Unlike the organizational structure of CIPF and IIROC[13], the U.K. regulators have been accorded rule-making powers for the compensation fund and are responsible for all appointments to the FSCS board. The FSCS is also required to provide reports to each of the PRA and FCA regarding its performance and must engage with the PRA when determining whether to act.

The FSCS Articles of Association provide that the regulators will appoint FSCS directors on terms to "secure their independence from the Regulators in the operation of the Scheme."[14] This principle is also found in section 212(5) of FSMA, but neither the statute nor the memoranda of understanding between the FSCS and each of the FCA and PRA provide insight as to the manner in which such independence is achieved. As a practical matter, no representative of the PRA or FCA serves as a director of the FSCS.

In 2011, HM Treasury published a Consultation Paper discussing the restructuring of the regulation of the financial services sector in the U.K. In the Consultation Paper, the importance of retaining the FSCS as a "single organization to administer compensation so that consumers have a single, accessible point of contact for compensation matters."[15] is expressly stated. The government also voiced its commitment to a model in which the body responsible for compensation is "…operationally independent of the regulators. Each of these bodies should continue to have a single focused objective or function which ensures their actions and decisions are unbiased and, rightly, are not directly influenced by wider regulatory considerations. This enables these bodies to provide the right outcomes for consumers."[16]

Canada Deposit Insurance Corporation

CDIC is a federal Crown corporation created by Parliament to provide deposit insurance to depositors of Canadian commercial banks and savings institutions. CDIC performs a function akin to that of CIPF, insuring deposits held at Canadian banks up to C$100,000 in the event of a bank failure. Like CIPF, CDIC is funded by member assessments. CDIC's member institutions are deposit-taking institutions regulated by the Office of the Superintendent of

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[11] The elimination of the Financial Services Authority ("**FSA**") in 2013 led to the creation of smaller bodies with discrete functions (namely, the PRA and the FCA).

[12] The duty to cooperate is also stipulated in FSCS's memoranda of understanding with each of the FCA and PRA. Each organization must exchange relevant information and keep each other informed of regulatory or market developments.

[13] Recognizing, of course, that IIROC is an SRO, while the FCA and PRA are government agencies or quasi-government agencies.

[14] See Section 7(c), Articles of Association of FSCS. The Chair's appointment and removal is subject to HM Treasury approval.

[15] See HM Treasury, *A new approach to financial regulation: building a stronger system*, February 2011.

[16] *Ibid*, page 99.

Financial Institutions ("**OSFI**"). OSFI, in turn, performs a function akin to that of IIROC, regulating federally registered banks, insurers and trust and loan companies as well as private pension plans subject to federal oversight.[17]

While, in practice, CDIC works closely with OSFI to achieve their common interest in the soundness of members firms, the two have distinct mandates and remain independent of one another.

The Wyman Committee Report of 1985 emphasized the importance of maintaining CDIC as an independent Crown corporation[18] and recommended measures to increase the range of expertise and independence of the CDIC board. In supporting Bill C-86 in June of 1986 (to, *inter alia*, add four private sector members to the CDIC board, the then Minister of State noted that "There must be a clear recognition that CDIC be…an integral element of the regulatory system, which is separate from those whom it is to regulate, and from those in government and other agencies who would manipulate it to serve the purposes of the Government, or the other agencies or their directors, as has occurred."[19]

In 1987, Bill C-42 increased CDIC's borrowing authority, increased the maximum annual premium rate, addressed a CDIC board substitution issue, and strengthened CDIC's powers to monitor troubled institutions, terminate insurance coverage, levy surcharges and conduct preparatory exams. This enhancement of CDIC's mandate reflected a recognition that CDIC required a stronger mandate and greater independence to minimize its risks.[20] While OSFI has the primary responsibility for regulating federally regulated deposit-taking institutions, CDIC may exercise certain supervisory functions, such as the ongoing monitoring of member institutions and ensuring their compliance with the *Canada Deposit Insurance Corporation Act* and its by-laws. If, for instance, OSFI identifies deficiencies in a member's financial condition, CDIC may conduct a special examination to investigate and better assess the extent of the issue.

When the idea of merging CDIC into OSFI was raised in 1994, it was ultimately determined to preserve CDIC as a separate entity.[21] Among the reasons cited for the rejection of the merger was the importance of preventing the moral hazard associated with assigning exclusive responsibility for both supervision and regulation to one agency. Commentators opined that retaining two agencies working closely together was the best way to avoid these issues.

The Financial Institutions Supervisory Committee ("**FISC**"), chaired by OSFI and of which CDIC is a member,[22] is one example of possible mechanisms to achieve better regulatory alignment without consolidating the separate agencies (and so avoid the moral hazard identified in the

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[17] OSFI, however, is not an SRO (but rather an independent federal government agency).

[18] Ian Kyer, *From Next Best to World Class: The People and Events That Have Shaped the Canada Deposit Insurance Corporation* (Canada: CDIC, 2017) at 125 – 126.

[19] CDIC, *An Overview of CDIC's History and Evolution 1967-2015*.

[20] CDIC, *An Overview of CDIC's History and Evolution 1967-2015*.

[21] Ian Kyer, *From Next Best to World Class: The People and Events That Have Shaped the Canada Deposit Insurance Corporation* (Canada: CDIC, 2017) at 205 - 208.

[22] The remaining members are OSFI, the Department of Finance, the Bank of Canada, and the Financial Consumer Agency of Canada.

context of discussions surrounding the potential merger of CDIC into OSFI).[23] The role of FISC is to regularly discuss matters relating to the supervision of financial institutions, including the development of strategies to deal with troubled financial institutions. In this way, FISC allows the views of safety net agencies with potential exposures to troubled financial institutions to influence the supervisory decision-making process.[24]

Integration

Recent decades have also seen changes in the provincial regulatory framework of the financial services industry in Ontario and Québec. These restructurings have taken a markedly different approach, integrating their respective compensation funds within the regulator.

Deposit Insurance Reserve Fund

The Deposit Insurance Corporation of Ontario ("**DICO**") was established in 1977 to insure deposits held in Ontario's credit unions and caisses populaires. It was constituted and governed by the *Credit Unions and Caisses Populaires Act, 1994* (Ontario) ("**CUCPA**"). The Financial Services Regulatory Authority of Ontario ("**FSRA**") was established as the financial regulator for the Province of Ontario under the *Financial Services Regulatory Authority of Ontario Act, 2016* (Ontario) following a consultation process initiated in 2015 by the Ontario Ministry of Finance (the "**FSRA Consultation**") to review the mandates of DICO, the Financial Services Tribunal and the Financial Services Commission of Ontario ("**FSCO**")[25]. Pursuant to the *Restoring Trust, Transparency and Accountability Act, 2018*, FSRA amalgamated with DICO in 2019. By virtue of this amalgamation, FSRA assumed responsibility for the prudential regulation of Ontario credit unions and caisses populaires. FSRA was also granted the responsibility to manage the DIRF originally managed by DICO and now possesses the power to manage, invest and disburse the money in the DIRF.[26]

DICO's mandate had been to: (i) provide insurance against the loss of part or all of deposits; (ii) promote standards of sound business and financial practices; (iii) ensure compliance with legislative and regulatory provisions related to the solvency of credit unions; and (iv) promote the stability of the Ontario credit union sector with due regard to its need to compete while taking reasonable risks.

In its 2016 final report, the review panel for the FRSA Consultation concluded that FSRA should operate as an integrated regulator of financial services with distinct market conduct, pensions, and prudential regulatory functions, operating independently of each other, yet in a coordinated and consistent manner. The report suggested that many of the functions performed by both DICO and FSCO could be better performed by a single integrated

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[23] The mechanisms that have been implemented so that the FSCS works effectively with the PRA and FCA are yet another example.

[24] CDIC and OSFI have jointly established a policy of early intervention when dealing with troubled institutions with graduated supervisory interventions that CDIC and OSFI can each take with respect to a troubled institution according to increasing gravity. Ultimately, CDIC has the power and authority to terminate a member institution's policy of deposit insurance, subject to the advice of the Minister of Finance. (CDIC, *Guide to Intervention for Federally Regulated Deposit-Taking Institutions*.)

[25] Together with DICO, FSRA's predecessor.

[26] The DIRF is mandated by CUCPA to pay deposit insurance claims, the costs of continuance or orderly winding up of credit unions in financial difficulty, and DICO's operational costs.

organization. The review panel specifically observed that such a consolidation could reduce costs, as well as bureaucratic and administrative burdens.

Fonds d'indemnisation des services financiers

The final report of the review panel for the FSRA Consultation was heavily influenced by the AMF structure and organization in Québec.[27] The AMF is an integrated regulatory body charged with the administration of all legislation governing Québec's financial sector, including the *Deposit Institutions and Deposit Protection Act* (the "**DIDPA**"). The AMF has been delegated authority to administer the FSCF. As an integrated regulatory system, compensation decisions under the FSCF are overseen by the AMF. Customers of investment dealers operating in Québec[28] continue to benefit from CIPF protection. While the AMF provides its coverage to mutual fund dealers operating exclusively in Québec through the FSCF, mutual fund dealers operating in one or more province or territory of Canada (in addition to Québec) benefit from IPC protection.

The AMF's 2017 report on the evolution of deposit insurance in Québec asserted that the AMF's structure helps to reduce administrative burden on firms and the "irritants" that result from the presence of multiple regulators. It was observed, for instance, that the establishment of a consolidated regulator laid the foundation for the link between supervisory and deposit insurance functions, which has allowed the AMF to effectively intervene with respect to deposit institutions in the event of a crisis. According to the AMF, this link facilitated the AMF's mandate to minimize risk by providing a better understanding of the market and enhancing the supervision of participants. In the AMF's 2017 report, it was also observed that, by bringing together specialized expertise in securities, insurance, deposit institutions and the distribution of financial products and services, collaboration and information-sharing became much easier.

Independence versus Integration

While the structure and organization of the compensation funds reviewed have revealed differences in the regulatory framework established in each jurisdiction and in the scope of the mandate of the compensation funds, the most significant difference appears to be whether the compensation fund is a body independent from the regulator or integrated within the regulator. In recent restructurings of the regulatory paradigm of a number of jurisdictions, the choice of approach has been actively considered (with jurisdictions reaching different conclusions).

Benefits of an Independent Compensation Fund Model

The benefits of an independent compensation fund model have been identified to include: (i) an ability to focus upon, and better execute, the distinct mandates of the regulator and the compensation fund, (ii) avoiding any inappropriate influence of political and regulatory factors upon the decisions of a compensation fund and (iii) greater consumer confidence.

Invariably, the mandates of a regulator and a compensation fund are distinct. The mandate of a compensation fund is focused upon the compensation of customers of regulated entities in prescribed circumstances and amounts and, often, includes liquidation and resolution

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[27] The final report encouraged the Ontario government to review the AMF's structure and the associated authorities when drafting FSRA's enabling legislation.

[28] Whether or not those investment dealers also operate in one or more other province or territory of Canada.

powers. The corresponding regulator's mandate is typically of broader scope including responsibility for systemic issues in addition to investor protection and market efficiency. The merger or consolidation of two distinct mandates can serve to obscure the distinction. The integration of resources risks diluting the specialized expertise and experience required at the board, in management and in operations of a compensation fund to efficiently and effectively fulfil its mandate. An independent compensation fund is better positioned to monitor and intervene in relation to a troubled member on an unbiased basis with a view to ensuring customers are protected.

A compensation fund independent from the regulator also enables decisions of the compensation fund to be made exclusively with reference to the fund's mandate free from extraneous political or regulatory considerations. The dispute which arose between the SEC and SIPC in the Stanford case perfectly illustrates the potential risks inherent in merging a compensation fund with a regulator.[29] The difference in mandates can give rise to a conflict of interest. If the regulator and the compensation fund are integrated, it is possible the decisions of the compensation fund may be inappropriately influenced by considerations not relevant to the mandate of the fund. This can, as SIFMA observed in the context of the Stanford case, imperil the financial capabilities of the fund itself. Ironically, the review panel for the FSRA Consultation concluded "as a matter of principle" that a regulator should not administer an insurance fund by reason of inherent conflicts of interest.[30] A healthy tension between a compensation fund and a regulator can foster an appropriate outcome for customers as well as the financial system as a whole.

An independent compensation fund inspires greater customer confidence. There is the confidence generated simply by the sense that the compensation fund stands apart with only the protection of customers as its objective. There is also the confidence generated by the access and clarity afforded by a single point of contact for coverage and discrete stand-alone disclosure relating to that coverage.

Benefits of an Integrated Compensation Fund Model

The benefits of an integrated compensation fund model have been identified to include: (i) improved cost and operational efficiency, (ii) reduced regulatory burden and (iii) greater regulatory alignment.

The operations and functions of a compensation fund and a regulator naturally overlap in certain respects, implying that there would be synergies of scale to be exploited were the compensation fund and the regulator to be integrated. Cost efficiencies and reduced duplication would likely be achieved. Administrative services, in particular, could be combined and reduce resource demands.

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[29] It is, of course, not the only circumstance in which a regulator and a compensation fund have disagreed. In 2011, CIPF and IIROC disputed the movement or withdrawal of assets from MF Global Canada Inc. in the period following the firm's suspension as a registrant and before the firm agreed to the appointment of a trustee. A number of institutional account holders and ICE Canada urged, and IIROC advocated, for the transfer of futures positions from the firm in the intervening period. CIPF did not agree with this approach given the impact this could have on its ability to return client assets and, in accordance with the terms of the Industry Agreement governing the relationship between CIPF and IIROC, CIPF's approach was adopted.

[30] Despite this conclusion, the review panel recommended the merger of FSRA and DICO.

Alternative means to achieve benefits

Cost and operational efficiencies generated by the synergies of scale associated with integration could, however, be achieved through outsourcing or resource-sharing arrangements. Greater sharing of technological platforms can serve to streamline the compliance obligations of industry participants and lead to significant reduction in regulatory burden. Currently, for instance, the web-based Securities Industry Regulatory Financial Form ("**SIRFF**") application system allows for a shared collection of data from member firms across multiple organizations, such as IIROC, CIPF, the CSA and the Canadian Depository for Securities Limited. Regulatory alignment can be achieved through enhanced information-sharing and collaboration. It is current practice for senior management, operational teams and Board Chairs of CIPF and IIROC to meet on a routine basis throughout the year. Further guidance as to possible approaches for enhancing regulatory alignment (while avoiding the risks of consolidation) can, perhaps, be found in mechanisms implemented in Canada and elsewhere. Examples of such mechanisms include the establishment and operation of FISC in Canada and the legislative provisions that have been designed so that the FSCS works effectively with the PRA and FCA in the U.K.

Conclusion

A compensation fund supports financial stability by affording investors protection in the event of a member firm insolvency. To that end, it is fundamentally important that the decisions and actions of the compensation fund are taken solely having regard to the mandate of the fund without regard for regulatory or political considerations, that the fund be perceived as singularly focused on the protection of customers, and that the fund be easily accessible. It is also imperative that the compensation fund remain solvent and financially robust, and instill customer confidence on a consistent basis.

For these reasons, maintaining the independence of a compensation fund is critical to minimizing the moral hazard that can be associated with the merger of various agencies with differing mandates under a single organization. Further, it allows a compensation fund to contribute meaningfully to the policy debate as a neutral party, thereby preserving a unique perspective that may become lost in one organization. These objectives argue strongly in favour of maintaining an independent compensation fund.

While there are benefits to integration, it is important to note both that the level of unnecessary or duplicative regulatory burden borne by members of CIPF and IIROC has been mitigated over time and that the benefits of integration can nevertheless be attained by different means. The healthy tension between regulator and compensation (or deposit insurance) fund leads to increased collaboration, which is a fact acknowledged to contribute to the stability of financial systems.[31]

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[31] For example, the information-sharing arrangement between OSFI, CDIC and the Bank of Canada has been recognized as helpful in maintaining the stability of Canada's financial system.