Summary

National Bank of Canada

Summary of the brief submitted to the Public Finance Committee

National Bank of Canada, as a major player in the Quebec mutual fund market, has always been very concerned with protecting investors and maintaining the industry's sound reputation. We can therefore understand why, in the wake of the recent series of exceptional and unfortunate events, Quebec's Public Finance Committee has initiated the current process.

Despite the losses some Quebec investors have suffered, people who place their money in mutual funds have, by and large, been adequately protected in the 25 years since the industry began to experience accelerated growth. Also, as is clear from the large sums they continue to invest in mutual funds, investor confidence in the mutual fund industry remains very high.

Therefore, while it is imperative to learn from the problems encountered by certain mutual fund managers, increasing the number of regulations applicable to mutual fund managers and distributors would likely prove counterproductive, since investors have, almost without exception until just recently, been very well protected by the current regulatory framework.

A disproportionate increase in regulations in an already complex industry could push up mutual fund operating costs to the detriment of the majority of investors. What is more, a lack of regulatory harmonization among the different regulatory authorities could unduly restrict the entry of new managers into the market, thus limiting the choice available to Quebec investors and the industry's long-term development in Quebec.

There is no doubt that recent events have brought to light certain weaknesses in the way the current regulations are applied, and National Bank supports tightening up audit and enforcement activities. This brief presents recommendations that would be relatively inexpensive to apply and which concern, specifically, the role of external auditors, plurality of functions and the involvement of the *Autorité des marchés financiers*. Any changes should, however, be harmonize with the initiatives of the other Canadian securities authorities, including Regulation 81-107.

SUMMARY OF RECOMMENDATIONS

Separation of Roles Versus Plurality of Functions

- ***Changing the rules affecting individuals:*** The plurality of functions performed by the same individual should be avoided.

Auditors

- ***Applying a minimum experience rule:*** The accountant in charge of an audit activity should have at least 5 years' experience in applying the *Act Respecting the Distribution of Financial Products and Services* and the *Securities Act* or its equivalent in other jurisdictions.

- ***Extending the scope of the audit:*** The auditor's report attesting compliance with Regulation 81-102 (parts 9, 10 and 11) should be extended to Part 6 so that the auditor audits the reconciliation of values emanating from the mutual fund, trustee and custodian.

- ***Rotating auditors:*** The rules requiring that mutual funds request security-holder approval before appointing an external auditor should be abolished in favour of a procedure setting the maximum term of the auditor's mandate.

Whistle Blowing

- ***Introducing whistle blower protection:*** Whistle blower protection should be introduced and the legal restrictions on communications between external auditors and the *Autorité des marchés financiers* should be eliminated.

Autorité des marchés financiers (AMF)

- ***Deepening expertise:*** The AMF must be able to rely on staff who have a greater knowledge of products, financial markets, operations and distribution in order to develop a "business intelligence" approach.

- ***Investor restitution:*** The AMF's powers should be broadened so it can return misappropriated funds and fraudulently or unlawfully acquired gains to investors without going before the civil courts.

Compensation

- ***Maintaining current conditions:*** It would be premature to extend compensation coverage. The existing rules should first be applied effectively.

Penalties

- ***Imposing stiffer penalties:*** Minimum fines and jail terms should be increased.

Communications

- ***Simplifying disclosure:*** Investors should be able to more clearly understand the investment products they purchase and document production costs should be reduced. The presentation of information among investments of the same type should be harmonized.

Regulations

- ***Maximizing the current regulatory framework:*** Any additional solution that is adopted to protect investors must not add to the regulatory burden or increase costs and must not limit the industry's development potential in Quebec.