MFDA Investor Protection Corporation
Corporation de protection des investisseurs de l'ACFM

ANNUAL REPORT 2018

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Information about the MFDA Investor Protection Corporation

The MFDA Investor Protection Corporation (the "MFDA IPC") is a not-for-profit corporation established by the Mutual Fund Dealers Association of Canada (the "MFDA") to administer an investor protection fund ("Fund") for the benefit of clients of mutual fund dealers that are members of the MFDA ("Member Firms"). The Fund protects client assets held by a Member Firm from an eligible loss in the event that the Member Firm becomes insolvent.

The MFDA is the sole self-regulatory organization that is the sponsor of the MFDA IPC. The MFDA IPC began offering coverage on July 1, 2005. At June 30, 2018, 92 mutual fund dealers across Canada participated in the Fund. The MFDA IPC operates in all provinces except Quebec, which has its own compensation fund.

MFDA IPC Coverage

The MFDA IPC covers customers who incur losses as a result of the insolvency of a Member Firm. Loss of customer assets may take the form of shortfalls in the amount and type of assets which are held by the Member Firm at the time of insolvency. The MFDA IPC's objective is to return assets to customers or compensate customers when the assets are not available because the Member Firm has become insolvent.

Coverage is available in the amount of up to $1 million for each of a customer's general and separate accounts. Most customers will have two "accounts" for coverage purposes, the aggregate of their trading accounts (general account) and the aggregate of their registered retirement accounts, such as RRSPs and RIFs (separate account). Securities, cash and other property of the customer that are unavailable due to the insolvency of the Member Firm are covered by the MFDA IPC.

Losses eligible for coverage by the Fund must be financial losses caused by the insolvency of a Member Firm. These losses must arise from the failure of the Member Firm to return or account for property of the customer held by or in the control of the insolvent Member Firm including the conversion of such property. Customer losses which do not result from the insolvency of a Member Firm such as losses that result from changing market value of securities, unsuitable investments or the default of an issuer of securities, are not covered.

The MFDA IPC's coverage of losses sustained by customers of insolvent Member Firms is within the discretion of the MFDA IPC. The Coverage Policy that has been adopted to describe the way in which such discretion is intended to be exercised to determine whether a customer is eligible for protection and the amount of that protection is available on the MFDA's website at www.mfda.ca/ipc.

Fund Resources

The MFDA IPC is funded through the levy of quarterly assessments on Member Firms. The balance of the Fund stood at $45.1 million as of June 30, 2018. The Fund target remains at $50 million as approved by the Board of Directors of both the MFDA and the MFDA IPC in October 2010. To reach the Fund target, Member Firms are assessed annually. The 2018 annual and replenishment assessments aggregated to $4.3 million and are allocated among the membership.

In addition to the annual assessments, the MFDA IPC maintains a credit facility of $30 million with a Canadian chartered bank which is guaranteed by the MFDA. Additionally, the MFDA IPC has placed $20 million of Fund insurance with international insurers. The insurance policy represents an additional resource to the MFDA IPC providing coverage in respect of losses in excess of $30 million in the event of a Member Firm insolvency while the policy is in effect.

Year In Review

In 2018, governance was a focus for the MFDA IPC as Board Chair, David Richards, retired and we welcomed new Board Chair, Professor Dawn Russell. Additionally, the MFDA IPC appointed a new Industry Director and re-appointed another Industry Director.

Throughout 2018, the MFDA IPC continued to focus on maintaining its operational readiness through continued enhancement of its policies and procedures, risk management programs and technology. There were no new insolvencies in fiscal 2018 and the MFDA IPC continued the wind-down of the insolvency of W.H. Stuart Mutuals Ltd. ("WHS"). In fiscal 2018, the MFDA IPC received and administered a small number of WHS claims.

Board Initiatives Fiscal 2018

Throughout fiscal 2018, the Board of Directors (the "Board") continued its work to ensure that the MFDA IPC is able to fulfill its mandate. Key Board initiatives included:

- Conducting the 2018 Public Director Nomination Process with the appointment of Professor Dawn Russell as the new Board Chair, replacing David Richards who retired
- Appointing Sean Etherington as an Industry Director, replacing Kevin Regan who retired
- Reappointing Sonny Goldstein as an Industry Director
- Conducting the annual review of the Fund size and monitoring the ongoing stability of the Fund
- Conducting its periodic review of the Coverage Policy
- Overseeing the continued enhancement of its Enterprise Risk Management program
- Overseeing the continued wind-down of the WHS insolvency
- Advancing the MFDA IPC's approach to risk management
- Conducting the quarterly review of investments
- Conducting the annual review and renewal of excess fund insurance
- Conducting the annual review and renewal of the credit facility

The Board held four regularly scheduled quarterly meetings.

Financial Review

Balance Sheet

The balance in the Fund stood at $45.1 million as at June 30, 2018, as compared to $40.8 million at June 30, 2017, an increase of $4.3 million over the previous year.

Total assets of $45.3 million are comprised primarily of investments of $44.6 million. Investments are recorded at amortized cost except for mutual funds which are recorded at fair value. The MFDA IPC's Investment Policy requires that all investments are debt instruments issued by Canadian or provincial governments or Canadian or provincial Crown corporations or corporate fixed income investments (for a portion of the portfolio). A portion of the portfolio is kept in short-term instruments to ensure liquidity.

Revenues and Expenses

The MFDA IPC's excess of revenues over expenses for the year ended June 30, 2018 was $4.3 million. Operating expenses for the year, excluding provision for claims and related expenses, were $1.1 million. Cost for WHS claims for fiscal 2018 were $20,046.

The MFDA IPC's chief source of revenue is Member Firm assessments, which are calculated based on the amount of assets under administration ("AUA") under the Member Firm's control. Each year, the fees are reset based on updated reports of AUA numbers. The MFDA IPC 2018 assessments to Member Firms totalled $4.3 million, in accordance with the plan to continue to build the Fund to a target of $50 million.

The assessments were comprised of an annual regular assessment of $2.9 million and an annual replenishment assessment of $1.3 million.

Investment income for the year ended June 30, 2018 was $1.1 million, a decrease from the previous year's amount of $1.2 million due to an unrealized loss on mutual funds compared to an unrealized gain in 2017.

Financial Outlook for fiscal 2019

Assessment revenue is expected to be approximately $2.7 million in 2019 comprised of the annual regular assessment of $1.4 million and replenishment assessment of $1.3 million.

Investment income at amortized cost is forecasted at $1.1 million, level with 2018, due to the continued increase in Fund size but offset with reinvestment of funds at lower rates.

The Fund expects regular fiscal 2019 operating expenses to be generally in-line with 2018.

Financial Statements

Independent auditors' report

To the Members of the
MFDA Investor Protection Corporation

We have audited the accompanying financial statements of the **MFDA Investor Protection Corporation**, which comprise the balance sheet as at June 30, 2018, and the statements of operations and changes in unrestricted fund balance and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for not-for-profit organizations, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the **MFDA Investor Protection Corporation** as at June 30, 2018, and the results of its operations and its cash flows for the year then ended in accordance with Canadian accounting standards for not-for-profit organizations.

Ernst & Young LLP

Toronto, Canada
September 25, 2018

Chartered Professional Accountants
Licensed Public Accountants

MFDA Investor Protection Corporation

Balance Sheet

Year ended June 30

	2018	2017
	$	$
Assets		
Cash	**235,158**	345,515
Investments, at cost (Note 3)	**38,200,610**	34,088,803
Investments, at fair value (Note 3)	**6,420,615**	6,199,014
Assessments receivable from MFDA (Note 4)	**39,242**	50,374
Interest receivable	**172,215**	118,346
Prepaid expenses	**225,028**	221,658
	45,292,868	41,023,710
Liabilities		
Accounts payable and accrued liabilities	**97,604**	85,253
Provision for claims and related expenses (Note 8)	**78,862**	154,937
Due to MFDA (Note 5)	**16,950**	25,894
	193,416	266,084
Fund balance		
Unrestricted	**45,099,452**	40,757,626
	45,292,868	41,023,710

See accompanying notes to the financial statements.

Approved on behalf of the Board

"Dawn Russell"

Director

"Sean Etherington"

Director

MFDA Investor Protection Corporation

Statement of Operations and Changes in Unrestricted Fund Balance

Year ended June 30

	2018	2017
	$	$
Revenues		
Assessments of MFDA Members	**4,303,590**	4,293,306
Investment income (Note 7)	**1,112,712**	1,193,673
	5,416,302	5,486,979
Expenses		
Bank, line of credit and insurance premiums (Note 6)	**394,673**	401,209
Personnel	**313,880**	408,987
Investment management fees	**115,044**	109,780
Directors' fees and expenses	**87,465**	92,082
MFDA support charges (Note 5)	**67,800**	67,800
Professional fees	**55,518**	70,793
Other operating costs	**20,050**	13,985
	1,054,430	1,164,636
Excess of revenues over expenses before the undernoted items	**4,361,872**	4,322,343
Provision for claims and related expenses (Note 8)	**20,046**	75,936
Excess of revenues over expenses	**4,341,826**	4,246,407
Unrestricted fund balance, beginning of year	**40,757,626**	36,511,219
Unrestricted fund balance, end of year	**45,099,452**	40,757,626

See accompanying notes to the financial statements.

MFDA Investor Protection Corporation

Statement of Cash Flows

Year ended June 30

	2018	2017
	$	$
Operating activities		
Excess of revenues over expenses for the year	**4,341,826**	4,246,407
Items not affecting cash		
Unrealized loss (gain) on investments	**2,830**	(172,318)
Realized loss on investments	**366**	972
Amortization of bond premium and discount	**214,438**	224,682
	217,634	53,336
Changes in non-cash working capital		
Assessments receivable from MFDA	**11,132**	82,772
Interest receivable	**(53,869)**	(8,186)
Prepaid expenses	**(3,370)**	6,232
Accounts payable and accrued liabilities	**12,351**	(84,481)
Provision for claims and related expenses	**(76,075)**	(30,258)
Due to MFDA	**(8,944)**	-
Cash provided by operating activities	**4,440,685**	4,265,822
Investing activities		
Purchase of investments	**(16,342,849)**	(14,969,918)
Proceeds from maturities and sales of investments	**11,791,807**	10,694,150
Cash used in investing activities	**(4,551,042)**	(4,275,768)
Decrease in cash during the year	**(110,357)**	(9,946)
Cash, beginning of year	**345,515**	355,461
Cash, end of year	**235,158**	345,515

See accompanying notes to the financial statements.

1. Organization

The purpose of the MFDA Investor Protection Corporation (the "MFDA IPC" or the "Corporation") is to administer an investor protection fund for the benefit of clients of mutual fund dealers that are members of the Mutual Fund Dealers Association of Canada ("MFDA"). The MFDA IPC protects client assets held by a MFDA member firm in the event that the member firm becomes insolvent. The Securities Commissions approved the creation of the MFDA IPC in May 2005, and the MFDA IPC began offering coverage on July 1, 2005.

The MFDA IPC was incorporated without share capital on November 14, 2002 under Part II of the *Canada Corporations Act* and continued under the *Canada Not-for-Profit Corporations Act* on February 19, 2014.

The MFDA IPC is a not-for-profit organization and, under the *Income Tax Act* (Canada) is exempt from income taxes.

2. Summary of significant accounting policies

These financial statements are prepared in accordance with Part III of the *CPA Canada Handbook – Accounting*, which sets out generally accepted accounting principles for not-for-profit organizations in Canada and includes the significant accounting policies summarized below.

Revenue recognition

The MFDA IPC follows the deferral method of accounting in the preparation of its financial statements.

The MFDA IPC's assessment dues of MFDA members are recognized as the services are rendered. Investment income consists of interest, dividends, income distributions from mutual funds, amortization of bond discounts/premiums and realized and unrealized gains and losses. Investment income is recorded in the statement of operations as earned.

Use of estimates and judgement

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant area requiring the use of estimates is the provision for claims and related expenses. Actual results could differ from those estimates.

Cash

Cash includes cash on hand and balances with banks and excludes cash balances in investment accounts, which are presented as investments.

Financial instruments

Investments recorded at fair value consist of investments in mutual funds and any investments in fixed income securities and equities not quoted in an active market that the Corporation designates upon purchase to be at fair value. Transaction costs are recognized in the statement of operations in the period during which they are incurred.

2. Summary of significant accounting policies (continued)

Investments in fixed income securities and equities not quoted in an active market and not designated to be measured at fair value are initially recorded at fair value plus transactions costs and are subsequently measured at cost or amortized cost using the effective interest rate method, less any provision for impairment.

All transactions are recorded on a trade date basis.

Other financial instruments, including assessments receivable from the MFDA, accounts payable and accrued liabilities and due to the MFDA, are recorded at fair value and are subsequently measured at cost, net of any provisions for impairment.

Provision for claims and related expenses

Provision for claims from clients of insolvent MFDA members is made when the MFDA IPC is notified of potential claims and the MFDA IPC makes a determination that the claims are eligible under its coverage policy. Provision for related expenses including trustee's fees, legal fees, consulting fees and other administrative costs is made when a reasonable estimate of the cost to administer the potential claims can be made. No amounts are provided as a contingency to cover possible losses and client claims for claims not yet reported.

3. Investments

Investments consist of the following:

	2018	2017
	$	$
Investments at fair value:		
Cash	**105,416**	65,579
Treasury bills	**2,483,075**	2,493,525
Mutual funds	**3,832,124**	3,639,910
	6,420,615	6,199,014
Investments at amortized cost:		
Bonds	**38,200,610**	34,088,803
	44,621,225	40,287,817

The treasury bills and bonds have a remaining term to maturity as follows:

	Remaining term to maturity			
	Within 1 year	**1 to 5 years**	**Over 5 years**	**2018**
	$	$	$	$
Treasury bills	2,483,075	-	-	2,483,075
Provincial bonds	3,738,181	7,112,849	7,399,773	18,250,803
Canada Housing Trust bonds	-	3,731,010	16,218,797	19,949,807
	6,221,256	10,843,859	23,618,570	40,683,685

4. Assessments receivable from MFDA

The assessments to MFDA members billed by the MFDA are due to the MFDA IPC upon collection by the MFDA. The amount of $39,242 (2017 - $50,374) represents outstanding amounts from MFDA members on billings due at June 30, 2018 of $2,749 (2017 - $29,557) and assessment amounts collected by MFDA but not yet remitted to the MFDA IPC of $36,493 (2017 - $20,817).

5. Due to MFDA

Due to MFDA includes support costs payable and amounts reimbursable for costs paid by the MFDA on the MFDA IPC's behalf.

The MFDA provides the MFDA IPC administrative, corporate secretarial and other support to allow the MFDA IPC to operate without its own support staff. The MFDA IPC and the MFDA have entered into a support agreement to define these areas of assistance. The amount of support costs for the year was $67,800 (2017 - $67,800) and was recorded at the agreed upon amount in the statement of operations. Payments are made on a quarterly basis. As at June 30, 2018, the MFDA IPC owed the MFDA $16,950 (2017 - $16,950) in respect of support costs.

6. Credit facilities and excess fund insurance

The MFDA IPC has been granted a credit facility limited to a maximum of $30 million (2017 - $30 million) by the Royal Bank of Canada (the "RBC"). The credit facility, in combination with the investments accumulated by the MFDA IPC, exists to provide protection to customers of members of the MFDA in the event of loss resulting from an insolvency of an MFDA member. The MFDA has guaranteed the $30 million line of credit to RBC in the event of default. To date, no amount has been drawn on the line of credit.

At June 30, 2018 the interest rate is prime + 0.75% per annum (2017 – prime + 0.75% per annum). In the absence of a drawdown, the RBC charges a standby fee on the credit line. This charge is included in bank charges in the statement of operations and changes in unrestricted fund balance in the amount of $135,000 (2017 - $135,000).

The MFDA IPC has arranged insurance in the amount of $20,000,000 in respect of losses to be paid by the MFDA IPC in excess of $30,000,000 in the event of a MFDA member insolvency.

7. Investment income

Investment income is comprised of the following:

	2018	2017
	$	$
Interest income	**1,105,204**	1,041,218
Accretion of the bond discounts and premiums	**(214,438)**	(224,682)
Distributions from mutual funds	**225,142**	205,791
Realized loss on mutual funds	**(366)**	(972)
Unrealized gain (loss) on mutual funds	**(2,830)**	172,318
Total investment income	**1,112,712**	1,193,673

8. Provision for claims and related expenses

At June 30, 2018 there continued to be one member insolvency, W.H. Stuart Mutuals, Ltd. ("WHS") for which claims continued to be received. The provision for claims and related expenses and the change in provision during the year and payments made for this insolvency is as follows:

	2018	2017
	$	$
Provision balance, beginning of year	**154,937**	185,195
Increase in provision	**20,046**	75,936
Payments during the year	**(96,121)**	(106,194)
Provision balance, end of year	**78,862**	154,937

At June 30, 2018, an accrual of $78,862 (2017 - $154,937) has been made for amounts expected to be paid to claimants and for administrative costs.

9. Financial instruments and risk management

Risk management relates to the understanding and active management of risks associated with invested assets. Investments can be indirectly exposed to foreign currency, interest rate, market and credit risk. The MFDA IPC invests in treasury bills, bonds and mutual funds. The MFDA IPC's investment policy sets out highly rated Federal and Provincial Government and Crown Corporation bonds as the allowable bonds for the MFDA IPC bond portfolio. Only Federal and Provincial notes are allowable for Treasury bill investments. The MFDA IPC's investments in mutual funds are limited to 10% of the overall value of the portfolio. The MFDA IPC's investment policy sets limits on the exposure to individual investments, such as limiting the maximum portfolio exposure to a single Province to 20%.

Risks that are relevant to the MFDA IPC are as follows:

Liquidity risk

Liquidity risk is the risk that the MFDA IPC will encounter difficulty in meeting obligations associated with its financial liabilities. The MFDA IPC is exposed to this risk mainly in respect of its accounts payable and accrued liabilities and provision for claims. The MFDA IPC manages liquidity risk by ensuring there is sufficient cash available to meet its commitments and holding assets that can be readily converted into cash. In addition, the MFDA IPC has a line of credit available with the RBC (Note 6).

Interest rate risk

The MFDA IPC is exposed to interest rate risk with respect to its investments in fixed income and mutual funds that holds fixed income securities because the fair value will fluctuate due to changes in market interest rates. In addition, the MFDA IPC is exposed to interest rate risk with respect to its operating line of credit because cash flows will fluctuate because the interest rate is linked to the bank's prime rate, which changes from time to time. The MFDA IPC does not engage in activities to

9. Financial instruments and risk management (continued)

mitigate this risk as it intends to hold the bonds to maturity and mutual funds for the long-term. The MFDA IPC has not drawn on the line of credit.

Credit risk

Credit risk refers to the risk of financial loss due to a counterparty failing to meet its contractual obligations. The MFDA IPC is exposed to credit risk indirectly through its investment in bonds, treasury bills and mutual funds. Credit risk is managed for these funds by limiting exposure to any single counterparty to a small percentage of net assets and by following the investment policy described above. Limiting the majority of investments to Canadian Federal and Provincial government bonds and notes and Federal and Provincial Crown Corporation bonds helps to mitigate the credit risk by investment in high-grade bonds.

As at June 30, 2018, the MFDA IPC’s bonds are held with a major Canadian chartered bank.

Market risk

Market risk is the risk that the value of an investment will fluctuate as a result of changes in market conditions, whether these changes are caused by factors specific to the individual investment or factors affecting all securities traded in the market. This risk is mitigated by the MFDA IPC’s policy of diversification of the investment portfolio. Market risk is considered to be minimal.

10. Comparative balances

Certain comparative balances have been reclassified to conform to the presentation adopted in the current year.

Board of Directors

The MFDA IPC Board of Directors is comprised of three public directors and two industry directors.

Public Directors

Professor Dawn Russell, Q.C., Chair
President & Vice-Chancellor, St. Thomas University

Beat J. Guldimann
President, Tribeca Consulting Group

Clayton S. Manness, BSA, MSc.
Former Minister of Finance, Manitoba

Industry Directors

Sean Etherington, MSM, CIM
President, Assante Wealth Management (Canada) Limited

Sonny Goldstein, CFP
President, Goldstein Financial Investments Inc.

Officers

Dorothy Sanford, FCPA, FCA
President

Odarka Decyk, CPA, CA
Vice-President and Controller

Bernadette Devine
Corporate Secretary

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