

October 10, 2013

Mr. Philip Howell  
Chief Executive Officer and  
Superintendent, Financial Services  
Financial Services Commission of Ontario  
5160 Yonge Street, Box 85  
Toronto, ON M2N 6L9

Delivered via email to:

**Re: Product Suitability Reviews of Life Insurance Agents**

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FAIR Canada would like to provide some comments further to FSCO's announcement that it will be, in the very near future, conducting a review to understand and assess the process that life insurance agents use at the point of sale to make suitable recommendations to prospective policyholders. FSCO has had as a strategic priority, in both its 2012 Statement of Priorities and its 2013 Statement of Priorities, a review of how insurance intermediaries make product recommendations to consumers. We are pleased that this initiative is underway.

### ***Compliance Review***

FAIR Canada has learned through the article in Investment Executive "[More rules for insurance advisors?](#)" that FSCO will be distributing a questionnaire by email to a randomly selected sample of insurance advisors and some survey respondents will be selected for follow-up.

**FAIR Canada recommends that FSCO consider enhancing its compliance review by conducting on-site reviews of a statistically significant number of different types of intermediaries (individual insurance agents/entities, agents who work for Managing General Agents, agents tied to particular insurance companies, and agents who are also mutual fund licensed or IIROC-licensed who work for insurance subsidiaries of banks). FAIR Canada believes that self-assessment of compliance by intermediaries should not be relied upon as a primary tool by regulators.**

FAIR Canada notes that in addition to on-site inspections, on-the-ground testing, such as "mystery shopping" can be valuable to determining whether, in practice, the processes being used have resulted in suitable product recommendations for consumers.<sup>1</sup> **FAIR Canada urges FSCO to conduct the product suitability review following, The International Association of Insurance Supervisors' "Core Principles, Standards, Guidance and Assessment Methodology", dated October 2011 (the "ICP").**

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<sup>1</sup> See Section 18.2 of the International Association of Insurance Supervisors' "Insurance Core Principles, Standards, Guidance and Assessment Methodology, October 1, 2011 and in particular, paragraph 18.2.6, available online at <http://www.iaisweb.org/index.cfm?pageID=795>.

## ***Survey of Consumers***

**FAIR Canada recommends that FSCO consider contacting a statistically relevant number of consumers of life insurance products, and in particular, consumers who hold segregated fund products, to determine consumers' financial awareness or understanding of what has been purchased.** For example, does the consumer understand that they have purchased a segregated fund rather than a mutual fund? Does the consumer understand the fees that are incurred in the purchase and that deferred sales charges will be incurred if they sell it prior to 7 years, in some instances? Was the consumer given the option of purchasing a mutual fund if the agent is dually licensed? Was the consumer aware that it could purchase a mutual fund, but not through the insurance agent, if the intermediary was not dually licensed? Is the consumer aware of the main differences between a segregated fund and a mutual fund and was the segregated fund more suited to the client's needs than the mutual fund (or not)? Did the consumer ever have a complaint and was this adequately dealt with? Securities regulators have in the recent past contacted clients of firms to assist in determining whether firms are complying with suitability and other regulatory requirements.

### ***Meaning of "Suitability"***

FAIR Canada urges FSCO, as part of the market conduct review, to consider whether the Industry Practices Review Committee ("IPRC") of the CCIR and the Canadian Insurance Regulatory Organizations ("CISRO") product suitability principle, that "the recommended product must be suitable for the needs of the consumer" is adequate to protect consumers (or not).

The IPRC states that the recommendation of a suitable product should be based on the following:

- Fact finding appropriate to the circumstances, and assessment of the client's specific needs;
- A flexible needs assessment. The assessment should reflect factors including the underlying risk, the client's objectives, and the complexity of the product being sold; and
- An agent or broker's product recommendation that meets the client's identified needs.

FAIR Canada urges FSCO, when conducting its market conduct review, to assess whether consumers are, in fact, being provided with suitable product recommendations and whether this process has been adequately documented. FAIR Canada notes that the CCIR in its Position Paper observes that agents do not know their specific obligations with respect to providing product recommendations that are suitable.<sup>2</sup> This poses real risks for consumers and needs to be examined as part of the product suitability review.

### ***Benchmark Inadequate for Segregated Funds***

According to the Investment Executive story, a benchmark for the reviews will be the best practices outlined in "The Approach: Serving the Client Through Needs-Based Sales Practices". FAIR Canada notes that this document is one used for all types of life insurance products and is not specific to investment-related products like segregated funds. It does not specify the type of information that needs to be gathered by the intermediary from the client, such as risk tolerance, capacity to incur losses, investment needs and objectives including investment time horizon and specific financial and personal

<sup>2</sup> Canadian Council of Insurance Regulators Position Paper, "The Managing General Agencies (MGAs) Distribution Channel in the Life Insurance Industry", May 2012 at 8. Available online at [http://ccir-ccra.org/en/init/Agencies\\_Reg/MGA%20position%20paper%20final%20EN2.pdf](http://ccir-ccra.org/en/init/Agencies_Reg/MGA%20position%20paper%20final%20EN2.pdf) at 9-10.

circumstances. FAIR Canada assumes that FSCO will review the intermediaries' processes and files to assess whether adequate information has been gathered from the client in order to make an assessment of whether the segregated fund was suitable for the consumer.

### ***Leveraged Investments***

FAIR Canada recommends that FSCO consider undertaking reviews of its insurance agents as part of its product suitability review to determine:

- 1) the extent and form of leveraged investing by the clients of insurance agents;
- 2) the particulars of the relationships regarding off-book loans and, specifically, the contractual arrangements between the insurance companies, the financing companies and the insurance agents;
- 3) whether existing marketing and advertising materials that encourage investors to borrow to invest are fair, balanced, and fully disclose the risks of such a strategy, and if not, take steps to minimize harm and prohibit insurance companies and their agents from using misleading materials;
- 4) the prevalence of unsuitable leverage recommendations; and
- 5) whether clients who have leveraged investments were provided with sufficient information to properly understand the risks associated with such strategies or the details of the debt servicing obligations that they had taken on as a consequence of using leverage by canvassing a statistically relevant survey of leveraged clients.

FSCO would then have valuable data on the extent of leveraged investing to inform regulatory action. Such action should include consideration of whether the existing regulatory framework is sufficient to protect consumers or whether specific regulatory requirements are needed. We refer you to our letter to you dated November 12, 2012<sup>3</sup> in which we brought to your attention, in writing, our concern that borrowing to invest is being recommended to consumers when it is not suited to their needs and in fact places consumers into inappropriate high-risk investment situations.

We would be pleased to discuss this letter and our recommendations with you at your convenience. Please contact Ermanno Pascutto at 416-214-3443 ([ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca)) or Marian Passmore at 416-214-3441 ([marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca)).

Sincerely,



Canadian Foundation for Advancement of Investor Rights

Cc: John M. Solursh, Chair of FSCO

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<sup>3</sup> Letter from FAIR Canada to FSCO dated November 12, 2012, available online at <http://faircanada.ca/wp-content/uploads/2011/01/121112-Letter-to-FSCO-re-leverage-Final.pdf>.