



Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

May 31, 2016

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

Sent via e-mail to: priorities@fSCO.gov.on.ca

Dear Mr. Mills,

RE: FAIR Canada's Comments on FSCO's Draft 2016 Statement of Priorities

FAIR Canada is pleased to offer comments on FSCO's priorities for 2016-2017 in response to its Draft 2016 Statement of Priorities (the "Draft Priorities").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. **Executive Summary**

Introduction

- 1.1. FAIR Canada supports the conclusion of the Preliminary Position Paper on the Review of the Mandate of FSCO that a restructured regulator is necessary.¹ We refer FSCO to FAIR Canada's recommendations to the Expert Panel and urge FSCO to make improvements, to the extent it can, given its existing mandate and resources.
- 1.2. When determining its Draft Priorities, FAIR Canada expects that FSCO will take into account the assessments of its performance contained in the Auditor General's Report and the 2014 IMF Report, as well as The Expert Panel's Preliminary Position Paper, and also will consider the written comments provided by stakeholders as a result of the work of the Expert Panel.

¹ FAIR Canada's letters to the Expert Advisory Panel –FSCO/FST/DICO Mandate Reviews dated August 21, 2015 and December 14, 2015, available online at http://faircanada.ca/wp-content/uploads/2015/08/150821-Letter-to-FSCO-Panel_Final.pdf and http://faircanada.ca/wp-content/uploads/2015/12/151214-Final-Letter-to-Expert-Panel-on-Preliminary-Panel-Recommendations_signed1.pdf.

- 1.3. Until fundamental reforms are undertaken as a result of the Expert Panel's final report, FSCO's Draft Priorities should be realistic, practical and move FSCO in the right direction in order to help meet its existing mandate. The focus of FSCO's work should therefore be on protecting financial consumers and protecting the integrity of the areas of the financial service marketplace it oversees. FAIR Canada has therefore assessed the Draft Priorities according to these criteria.
- 1.4. While the Draft Priorities recognize the importance of "...partnerships and dialogues with stakeholders from the financial services industry participants to the consumers and pension plan beneficiaries..."², the emphasis throughout the Draft Priorities is on engaging with industry rather than engaging with consumers or pension plan members. FSCO's Draft Priorities goes so far as to state, "[w]e look forward to hearing the insight and opinions of *our industry stakeholders*, and look to them for confirmation that the direction we are taking will *meet their needs and expectations*"³ (emphasis added). FSCO needs to make a concerted effort to obtain the views of consumers and consumer organizations as it formulates its Draft Priorities and as it undertakes its work. FSCO also needs to meet **their** needs and expectations, and it must publicly commit to doing so.
- 1.5. Having an unwavering focus on protecting financial consumers and protecting the integrity of the financial services marketplace is fundamental to being an effective regulator. Presently, FSCO does not have effective consumer engagement in its policy-making processes. FSCO needs to acknowledge this and take steps to address the issue. FSCO will not succeed at fulfilling its mandate if it does not make efforts to engage with consumers and obtain the consumer perspective. We refer FSCO to our letters to the Expert Panel as regards recommendations relating to effective consumer stakeholder engagement.

2. FAIR Canada's Comments on FSCO's Detailed Priorities

Draft Priority 1: Ensure financial services industry compliance with laws and regulations

- 2.1. FAIR Canada expects that FSCO will focus on this key aspect of its mandate and will work to improve its ability to ensure compliance with existing rules, improve its oversight and utilize enforcement resources against those who violate the rules. We strongly recommend that FSCO utilize its resources to proactively oversee those it regulates and audit their compliance with the rules. We also recommend that FSCO work to ensure that there is adequate handling of consumer complaints by FSCO and by those it regulates.
- 2.2. FAIR Canada adds that the life insurance product suitability review conducted by FSCO and the Auditor General noted significant problems with respect to the level of compliance with existing laws and regulations. This needs to be addressed.
- 2.3. More fundamentally, FAIR Canada has consistently commented to FSCO that the current product suitability process is inadequate, has serious flaws, does not comply with international principles for insurance and does not lead to good outcomes for consumers. Addressing these problems should be a top priority.

² FSCO's Draft Priorities, at page 1, paragraph 5; available online at https://www.fSCO.gov.on.ca/en/about/annual_reports/pages/2016-sop-draft.aspx.

³ FSCO's Draft Priorities, at page 1, paragraph 5.

- 2.4. FAIR Canada is strongly of the view that the existing insurance laws and regulations are drafted in way that makes it difficult for FSCO to ensure the entities and intermediaries it regulates are in compliance. An overhaul of these laws and regulations is needed in order to adequately protect consumers. Self-regulation through industry guidance has proved to be inadequate and insufficient. For example, life insurers have a legal duty to ensure that their sponsored life insurance agents comply with applicable regulations and that their agents are suitable to be licensed as agents. However, in practice, life insurers are unable to fulfill their duty with any rigour because many life insurance agents no longer work directly for an insurer. Moreover, insurance laws and regulations need to be overhauled in order to meet Canada's G20 obligations and meet international principles. We therefore urge FSCO to work to change the existing regulatory framework.
- 2.5. As the necessary reforms progress, FAIR Canada strongly urges FSCO, governments and the Expert Panel to obtain the consumer perspective. Consumer stakeholder engagement should be sought regarding such issues as the market conduct of insurance and reforming the distribution of insurance. Reforms should not result from discussions solely between regulators and industry (including industry groups such as the Canadian Life & Health Insurance Association ("CLHIA") in order to "fine-tune details" as is suggested in the CLHIA's recent report on life insurance distribution in Canada.⁴ Rather, a policy-making process which critically evaluates current consumer outcomes and that has robust consultation with and input from consumers and consumer groups is vitally important.
- 2.6. We are aware that the Canadian Council of Insurance Regulators ("CCIR") has recently issued a Segregated Funds Working Group Issues Paper with respect to the fair treatment of customers in the regulatory frameworks for segregated funds. We are pleased to see this initiative. Long overdue is a review by Ontario of the regulatory regime for all insurance products with an investment component (segregated funds, whole life insurance, universal life insurance, etc.) in order to ensure there are common and consistent standards for all financial products with an investment component and all financial intermediaries who recommend such products. The ultimate goal is adequate consumer protection and optimal consumer outcomes. We encourage Ontario and the CCIR to obtain fulsome input from all stakeholders, including consumer focussed organizations.

Draft Priority 5: Influence the development of provincial, national, and international regulatory policy

- 2.7. FAIR Canada agrees that promoting regulatory coordination and greater consistency among inter-jurisdictional partners may foster a healthy financial services sector by providing similar levels of consumer protection across Canada. To do this, regulatory coordination needs to be

⁴ CLHIA has recently published out a report about Canadian life insurance distribution in Canada with a number of policy recommendations called "Insurance Distribution in Canada: Promoting a Customer Focused System. CLHIA is a non-profit association representing Canadian life & health insurance companies, whose mission, according to its web-site, is "...to serve its members in interests of common need, or concern" and whose objectives include "promot[ing] a legislative and regulatory framework favourable to the business of its members." CLHIA's report is available online here: <http://clhia.uberflip.com/i/644367-insurance-distribution-in-canada>. See the mission and objectives of the CLHIA, available online at https://www.clhia.ca/domino/html/clhia/CLHIA_LP4W_LND_Webstation.nsf/page/6EBFE54D9D076C568525780E0056B1BE?OpenDocument.

viewed broadly, with an overarching public interest focus, involving sectors currently regulated by FSCO as well as those outside FSCO's regulatory domain. Regulatory coordination should not, however, lead to the lowest common regulatory standard being adopted. Harmonization should mean adopting best practices and bolstering consumer protection across jurisdictions, not engaging in a race to the bottom.

- 2.8. FAIR Canada therefore encourages FSCO to strengthen its relationships with other provincial regulators (both within and beyond Ontario) and federal regulatory bodies so as to improve the quality of regulatory oversight in Ontario.
- 2.9. We also encourage FSCO to work to expand information-sharing, especially with respect to enforcement. Specifically, there is a need for an interprovincial licensing system and a need for automatic reciprocal enforcement of disciplinary orders by regulators, whether governing insurance, securities, or mortgage brokers. Disciplinary action against an individual and/or a firm by any financial services regulator should automatically result in equivalent disciplinary action by FSCO. The 2014 Auditor General Report pointed out that 66 dual-licensed individuals who were disciplined by the MFDA were not subjected to any proactive, immediate examination of their life insurance agent activities or suitability to continue as licensees. It also indicates that FSCO has responded to its findings, in part by entering into a Memorandum of Understanding with the MFDA and exploring other information-sharing arrangements.⁵ We encourage FSCO to move forward with such steps. FSCO should also work with criminal enforcement bodies (such as IMET and provincial police), particularly to help combat fraud.
- 2.10. There is also urgent need for a comprehensive, user-friendly national database to assist Canadian consumers in checking the registration/licensing and disciplinary history of any person or firm offering investment or financial advice. The database should include information on all individuals and firms offering investment advice, whether that advice comes from someone in the insurance sector, securities regulated sector, mortgage broker sector or the banking sector.
- 2.11. In addition, the harmonization of the regulatory framework for investment products needs to be undertaken so that regulatory requirements are substantially the same when the product is substantially the same: the advice provided by life insurers, managing general agencies, life insurance agencies and their life insurance agents on the insurance side should be at the same standard as that required of dealers, advisers and their registered representatives on the securities side. This includes implementing similar relationship disclosure requirements, cost and performance requirements for insurance products with an investment component and point of sale disclosure requirements. Currently, consumers are completely in the dark as to the amount of commissions and other forms of compensation that their life insurance agent is earning on the sale of life insurance products, including segregated funds, whole life policies and other products that have an investment component.
- 2.12. FAIR Canada believes that Canada needs to work to catch up to international standards and best practices in order to improve our financial system and provide adequate protection for financial consumers. We think it is unlikely that FSCO will meet its objective of influencing international regulatory policy. A more realistic objective would be for FSCO to endeavour to help meet our current G20 obligations and to work to institute reforms that will implement international

⁵ 2014 Auditor General Report at page 151.

standards such as those set by the international Joint Forum, including the Point of Sale Disclosure in the Insurance, Banking and Securities Sectors⁶, the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS)⁷ and IOSCO's Suitability Requirements with respect to the Distribution of Complex Financial Products⁸. European policy makers, for example, require short, standard, plain language disclosure documents for all retail investment products, including all packaged retail and insurance-based investment products (PRIIPs). Such initiatives should be closely examined and considered by regulators in Canada.

2.13. FAIR Canada also believes that FSCO could be part of a regulatory initiative to examine the defined contribution regulatory framework in order to improve outcomes for consumers. The review of this area should inquire as to:

- (i) Is there adequate regulation – or indeed any regulation - of the intermediaries (often called “benefit consultants”) who make recommendations to employers about DC pension schemes (which are comprised of a number of different investment products)?
- (ii) What are the conflicts of interest present between those offering the plan, the employer and the employees who will be required to be members of the plan? How are conflicts avoided, managed or disclosed?
- (iii) Are the level of charges and costs reasonable and is disclosure clear and transparent - to employers and to employees who bear the costs through reduced savings that otherwise could be achieved?
- (iv) Is the level of governance for these plans adequate to provide good representation for the needs of members of the plans?
- (v) Are there regulatory gaps that need to be addressed so that persons enrolled in DC plans have adequate protections and good outcomes and so that a competitive marketplace will exist in the interests of consumers?

Draft Priority 6: Enhance the collection, use, and sharing of market intelligence

2.14. Given FSCO's limited resources, it should work closely with other regulators to share information in order to improve its abilities with respect to compliance oversight and enforcement. As noted above, FSCO could automatically reciprocally enforce the disciplinary decisions of other regulators governing insurance, securities and mortgage brokers, in order to protect consumers and achieve a level of deterrence.

2.15. FAIR Canada urges FSCO to engage in proactive activities in order to provide adequate oversight

⁶ Point of Sale Disclosure in the Insurance, Banking and Securities sectors, April 2014. The Joint Forum (Basel Committee on Banking Supervision, International Organization of Securities Commissions, International Association of Insurance Supervisors).

⁷ See especially ICP 18 and 19 which address the supervision of market conduct and intermediaries, International Association of Insurance Supervisors, Insurance Core Principles, updated November 2015, available online at <http://www.iaisweb.org/page/supervisory-material/insurance-core-principles//file/58067/insurance-core-principles-updated-november-2015>.

⁸ Suitability Requirements with respect to the Distribution of Complex Financial Products: Consultation Report, Technical Committee of the International Organization of Securities Commissions, CR03/12, February 2012.

and enforcement of the areas it regulates. It must engage in proactive examination activity, conduct compliance sweeps and promptly investigate complaints it receives. It should conduct an independent analysis of the complaints against those it regulates (for example, complaints against insurers and intermediaries) as this is a valuable source of information about poor conduct in the area of intermediation.⁹

- 2.16. FSCO needs to take a close look at its compliance review program and its adequacy. It should meet international standards for the supervision of those it regulates, such as insurance intermediaries.¹⁰ It must move beyond relying on discussions with industry and questionnaires to licensees in order to see if consumers are being adequately protected.¹¹ FSCO needs to conduct on-site inspections of a statistically significant number of different types of intermediaries. Self-assessment of compliance should not be relied upon as a primary tool by regulators.
- 2.17. In addition to on-site inspections, on-the-ground testing, such as “mystery shopping”, should be considered in order to evaluate whether intermediaries’ policies and procedures have transferred into fair outcomes for consumers.¹²
- 2.18. FAIR Canada recommends that FSCO consider contacting a statistically relevant number of consumers of life insurance products, especially consumers who hold segregated funds and whole life and universal life policies, to determine consumers’ financial awareness of what has been purchased and whether consumers understand what these products cost. FSCO should also determine whether these products are well understood by those who sell them.
- 2.19. In carrying out its supervision obligations, FSCO should take a risk-based approach. This means focusing on areas that are of higher risk such as where intermediation includes advice, where the products are complex and long-term with a significant investment element and where the consumers are less sophisticated.

Draft Priority 8: Provide adequate disclosure of information to enable informed decisions by consumers and pension plan members

- 2.20. FAIR Canada agrees that educating consumers is important to protecting them against “scams”.¹³ Public education is an important component of an effective strategy to combat fraud. A certain amount of fraud is perpetrated by individuals who are not licensed or registered. Investor harm could be avoided if investors verified that the individual and firm they deal with, or intend to deal with, are registered or licensed. The absence of such registration or license provides an opportunity for the individual to scrutinize or avoid the transaction.

⁹ See Section 18.2.3 of the International Association of Insurance Supervisors’ “Insurance Core Principles”.

¹⁰ See section 18.2 of the International Association of Insurance Supervisors’ “Insurance Core Principles”.

¹¹ See FSCO’s Life Insurance Product Suitability Review Report, Financial Services Commission of Ontario Market Regulation Branch, September 2014, available online at <https://www.fSCO.gov.on.ca/en/insurance/Documents/2014-life-product-suitability-rpt.pdf>, Methodology at page 3.

¹² See section 18.2.6 of the International Association of Insurance Supervisors’ “Insurance Core Principles”.

¹³ FSCO Draft Priorities at page 5.

However, many individuals never check the background of their advisor.¹⁴

- 2.21. FAIR Canada therefore recommends that the check registration system be overhauled so that it is both simple for people to use and comprehensive, as set out in paragraph 2.10 above. Raising public awareness of the ability to check registration is also necessary.
- 2.22. As part of this review, the mortgage broker check system will need to be addressed as it appears to be deficient. It does not always provide a positive search result for an individual who is actually a licensee in Ontario. In addition, obtaining this information through contacting the regulator directly appears to not lead to timely information being provided.¹⁵ We therefore urge FSCO to review and improve the mortgage broker check system.
- 2.23. The Draft Priorities state that: "Currently, FSCO has a responsibility to disclose information to the public about our enforcement actions to better protect them against fraud."¹⁶ Alerts and notices that warn investors of frauds, schemes and other wrongful or non-compliant behaviour are necessary. These alerts allow regulators to inform the public of activity of concern that regulators are aware is being conducted in their jurisdictions. The warnings and alerts can be posted on regulators' websites and disseminated through email distribution lists and social media. However, while such warnings are useful and an important tool, it is unclear whether potential victims are likely to find and read these warnings prior to being approached with a fraudulent investment. FSCO should therefore acknowledge the limitations of this disclosure and ensure that other fraud prevention methods are also utilized.
- 2.24. Similarly, public education, while vitally important, cannot be the prime mechanism for preventing fraud – detection and deterrence are also key. Frauds work by suspending disbelief, which means anyone is susceptible to being victimized.¹⁷ This point was recently raised by the UK's Financial Conduct Authority, whose director of enforcement, Mark Steward, said "[y]ou don't need to be gullible to lose money to a scam or fraud. Fraudsters target financially sophisticated people too, who often don't like to ask what might sound like silly or basic questions."¹⁸ We must therefore also work diligently to improve detection and deterrence.
- 2.25. FAIR Canada believes that a deterrence-based approach to regulatory enforcement is appropriate to combat fraud. Fraudsters are not generally law-abiding and will violate law where they perceive the benefits exceed the cost of sanctions. Strong enforcement with the threat of real sanctions, including jail time, is needed in order to deter fraudsters. FAIR Canada agrees that there are growing risks in areas such as syndicated mortgages and related investments allegedly tied to charges on real property or otherwise. There appear to be a number of frauds in this area and it is imperative that effective enforcement resources are provided to address this in Ontario. FAIR Canada believes that FSCO should prioritize fraud

¹⁴ FAIR Canada, August 2014, A Report on a Canadian Strategy to Combat Investment Fraud, at page 36, available online at <http://faircanada.ca/wp-content/uploads/2014/08/FINAL-A-Canadian-Strategy-to-Combat-Investment-Fraud-August-2014-0810.pdf>.

¹⁵ A recent inquiry took over two weeks to obtain a response.

¹⁶ FSCO Draft Priorities at page 5.

¹⁷ Maria Konnikova, 2016, The Confidence Game: Why We Fall for it. Every Time.

¹⁸ UK Financial Conduct Authority Press Release, "Over 55s at heightened risk of fraud, says FCS" (May 25, 2016), available online at: <https://www.fca.org.uk/news/over-55s-at-heightened-risk-of-fraud-says-fca>

prevention.

- 2.26. To ensure effective enforcement, transparency and accountability mechanisms need to be built into the system. Regulators, including FSCO, should track and make public data on consumer complaints (such as fraud complaints), the number of investigations from those complaints and the number of proceedings commenced and concluded.
- 2.27. FAIR Canada believes that in respect of ensuring that consumers receive good outcomes from those who provide financial services, educating consumers to prevent misunderstandings and providing them with a clear understanding and explanation of their rights and responsibilities is important but is not sufficient to address the problems that exist. FAIR Canada has long called for a statutory best interest standard in order to address problems with the consumer-advisor relationship. Problems include: the low level of financial literacy of Canadians, the increasing complexity of financial products, the degree of knowledge that individuals have compared to that of the firm and individual advisor (also known as “information asymmetry”) and the expectation that individuals have that the financial services intermediary will act in their best interests (although this is not currently the standard of conduct).¹⁹ Accordingly, FAIR Canada believes that other reforms are needed to protect consumers adequately, including implementing a best interest standard.
- 2.28. More is required than merely educating the public as to the actual standard of conduct that their advisor, mortgage broker or pension provider must adhere to, in order to prevent “misunderstandings”²⁰. The regulatory regime needs to be overhauled so as to provide adequate protections to consumers. Rather than focusing on educating the public as to their “rights and responsibilities when interacting with financial services representatives”,²¹ what is urgently needed is:
- (i) a regulatory regime that oversees whether the products being sold to consumers meet their needs and are in their best interests;
 - (ii) consistent treatment of consumers across the regulatory spectrum;
 - (iii) an adequately funded and informed consumer voice that is part of the policy-making process; and
 - (iv) a statutory best interest standard applicable whenever financial advice or recommendations are provided to consumers.
- 2.29. FSCO needs to have the resources and ability to provide proactive oversight and enforcement and address inadequate market conduct standards in order to improve consumer protection

¹⁹ CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients (October 25, 2012) available online at: http://osc.gov.on.ca/documents/en/Securities-Category3/csa_20121025_33-403_fiduciary-duty.pdf and CSA Consultation 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients (April 28, 2016) available online at: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm

²⁰ FSCO Draft Priorities at page 5.

²¹ FSCO Draft Priorities at page 5.

and provide good outcomes to consumers and pension plan members.

- 2.30. FSCO's work to improve financial literacy of consumers and pension plan members should draw on the resources and expertise of the several bodies that work diligently to improve financial literacy of Ontarians. In addition, financial literacy should be viewed as a responsibility shared by firms and individual licensees or registrants.²²

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408/neil.gross@faircanada.ca or Marian Passmore at 416-214-3441/marian.passmore.@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights

CC: Ontario Ministry of Finance
Expert Panel re review of FSCO
Expert Panel re Financial Planning and Financial Advisory Policy Alternatives

²² See Principle 6 of the Organisation for Economic Co-operation and Development (OECD), "Principles and Good Practices for Financial Education and Awareness" (July 2005), online: Principle 6 reads: "The role of financial institutions in financial education should be promoted and become part of their good governance with respect to their financial clients. Financial institutions' accountability and responsibility should be encouraged not only in providing information and advice on financial issues, but also in promoting financial awareness clients, especially for long-term commitments and commitments which represent a substantial proportion of current and future income."