

June 6, 2012

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

Delivered via email to: priorities@fSCO.gov.on.ca

Dear Mr. Howell:

Re: Financial Services Commission of Ontario (“FSCO”) Draft Statement of Priorities & Strategic Directions dated April 2012

FAIR Canada is pleased to offer comments on FSCO’s Draft Statement of Priorities & Strategic Directions (the “Draft Statement”).

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investment protections in regulation. Visit www.faircanada.ca for more information.

FAIR Canada Comments and Recommendations – Executive Summary

FSCO’s legislative mandate is “to provide regulatory services that protect the public interest and enhance public confidence in the sectors it regulates”. FSCO has set as its vision “[t]o be an effective regulator that protects the public interest and supports a strong financial services sector”. The core of FSCO’s mandate is its responsibility to protect the public interest and its priorities, strategies and initiatives must ensure that financial consumers will be protected. FSCO has set out a number of initiatives to operationalize its strategies and has also set out a number of strategic outcomes it hopes to achieve. FAIR Canada welcomes the opportunity to provide its comments on FSCO’s initiatives and strategic outcomes and to provide our recommendations to improve regulation for the benefit of financial consumers.

1. Add Initiative - Improve Communication with and Accountability to Consumers

- 1.1 FAIR Canada recommends that FSCO undertake a specific initiative to further the ways in which it communicates with and is accountable to financial consumers.
- 1.2 FAIR Canada recommends one means of obtaining the views of financial consumers would be through strengthening the Consumer Advisory Committee (the “Committee”) which FSCO created in 2001. FAIR Canada recommends that the Committee be provided with greater resources and its members be compensated for their time and effort in meeting the Committee’s mandate in a

manner similar to the Ontario Securities Commission's Investor Advisory Panel so that that it can provide more meaningful consumer input to FSCO that is transparent to the public.

2. Add Initiative – System to Conduct a Comprehensive Background Check is Needed

- 2.1 FAIR Canada believes that there is a real need for a single, comprehensive search function that would allow investors to check the regulatory background of a potential agent or life insurance agency or managing general agency. The current process of verifying that a potential agent is registered and has a good disciplinary history is unnecessarily complex and confusing for consumers.
- 2.2 We urge FSCO to urgently address the ability of an insurance agent or insurance agency to continue to provide product recommendations and “advice” to consumers as an insurance agent or insurance agency if it has been sanctioned and banned by a provincial insurance regulator or a provincial securities regulator¹.

3. Initiative - Conduct Life Insurance Product Suitability Reviews

- 3.1 The focus of the upcoming review, according to the Draft Statement is to “...understand and assess the processes life insurance agents use in making recommendations to consumers and the processes in place at life insurance companies when developing and distributing products.” FAIR Canada noted in its submission last year that many segregated funds and other life insurance products with investment components are complex. FAIR Canada agrees that many consumers will have difficulty in understanding them and that this creates a risk for consumers. A timely review of the product suitability process needs to be conducted. In addition, FAIR Canada believes that a substantive assessment of the adequacy of the process and recommendations to improve it are overdue.
- 3.2 In the interest of transparency and effectiveness, FAIR Canada recommends that FSCO include in its final Statement of Priorities details on the proposed approach and scope of the market conduct review. 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 consumers².
- 3.3 FAIR Canada recommends that FSCO consider setting out *regulatory requirements that insurance agents must meet so that suitability is properly determined before recommendations are made for clients. We recommend that the requirements for product suitability be similar to IIROC Dealer Member Rules 1300 and 2500 and MFDA Rule 2.2.1 and Policy No. 2.* FAIR Canada notes that the CCIR in its Position Paper³ observes that agents do not know their specific obligations with respect to providing product recommendations that are suitable. This poses real risks for consumers and needs to be addressed.
- 3.4 FAIR Canada recommends that FSCO add as a Strategic Outcome from the above-noted initiative, **“Increased Compliance with Product Suitability Requirements ”**.

¹ See FAIR Canada Newsletter on the topic, dated August 2011, available online at <http://archive.constantcontact.com/fs070/1102284477892/archive/1107399885184.html>.

² 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>.

³ CCIR Position Paper “The Managing General Agencies (MGAs) Distribution Channel in the Life Insurance Industry” May 2012; available online at http://ccir-ccra.org/en/init/Agencies_Reg/MGA%20position%20paper%20final%20EN2.pdf.

- 3.5 FAIR Canada recommends that FSCO add to its product suitability review, an examination of the prevalence of recommending borrowing to invest, particularly focusing on segregated funds, under its first strategy (“Review and recommend changes to better mitigate risk”).
 - 3.6 FAIR Canada advocates for the adoption of a new model of consumer protection for complex financial products, including segregated funds. This new model would place the burden on parties who sell complex financial products to consumers (meaning insurance companies, distributors and agents) to ensure that their sales force, clients and the end consumer actually understand the products being sold; the costs, fees and risks associated with those products; and the implications of the disclosure documents provided. In other words, FAIR Canada advocates the replacement of a standard of informational disclosure with a standard of active knowledge.
 - 3.7 The product suitability review should consider the steps taken to address the asymmetry of information between well-resourced, sophisticated insurance companies and their insurance agents, and their unsophisticated consumers.
 - 3.8 FAIR Canada recommends that FSCO consult with stakeholders on increasing proficiency standards for insurance agents.
 - 3.9 FAIR Canada recommends that FSCO make it a regulatory requirement that, in order to be licensed to sell segregated funds, an agent must also be licensed to sell mutual funds or other lower cost products.
 - 3.10 We recommend that FSCO add as a specific strategy the issuance of a consultation paper in 2012 on implementing a “best interest of the client” standard for all market intermediaries.
 - 3.11 FAIR Canada recommends that the adequacy and appropriateness of the CCIR Principles for Managing Conflicts of Interest be reassessed in light of the evolving “best interest of the client” international standard.
- 4. Initiative - Work with the Ministry of Finance to Review Major Parts of the Insurance Act and other Insurance-Related Legislation**
- 4.1 FAIR Canada urges FSCO to consult with stakeholders when considering legislative change so that consumer and retail investor advocates have an opportunity to provide their input into the policy-making process.
- 5. Examine CCIR Recommendations to Reflect Changes in Distribution Channels**
- 5.1 FAIR Canada recommends that FSCO and the CCIR reach out to consumer-based organizations, if they have not already done so, to obtain the views and perspectives of the consumer when determining whether there are any regulatory gaps or risks to consumers, and in respect of any recommendations or proposed changes to the regulatory framework. It is essential to an effective policy-making process that financial consumers are consulted and their input is received. Sufficient funding should be provided to the Committee in order to allow it to provide written comments. FSCO and the CCIR, and Ministry of Finance officials, should take proactive steps to obtain the consumer perspective on the issues identified in the CCIR’s Position Paper and any proposed reforms to the Insurance Act, given the importance of the areas addressed and the issues identified.
 - 5.2 FAIR Canada believes that consumers would benefit from having the area of consumer redress for insurance product-related complaints reviewed against our obligations under the G20 High-Level

Principles on Financial Consumer Protection, and the ICP, and what is the current practice and standard in other leading jurisdictions and other relevant benchmarks.

1. Mandate and Vision of FSCO

- 1.1. FSCO is an integrated financial services regulator that regulates several sectors including insurance companies, agencies and insurance intermediaries who sell life and health insurance, including segregated fund contracts and other insurance products which have an investment component. FSCO's strategic priorities and activities directly impact many financial consumers who obtain products and services from life insurance agents in Ontario. Many of these life insurance agents are financial service providers, (also known as "financial planners", "financial advisors" or "wealth management specialists" (amongst other terms)), who are also licensed to sell mutual funds and other securities products.
- 1.2. FAIR Canada, as a voice of financial consumers, is pleased to provide input into the development of policy pertaining to the distribution and sale of insurance products with an investment component, with a view to increasing protection for financial consumers.
- 1.3. FSCO's legislative mandate is "to provide regulatory services that protect the public interest and enhance public confidence in the sectors it regulates". FSCO has set as its vision "[t]o be an effective regulator that protects the public interest and supports a strong financial services sector". **The core of FSCO's mandate is its responsibility to protect the public interest and its priorities, strategies and initiatives must ensure that financial consumers will be protected.**

2. FSCO's Priorities, Strategies and Initiatives

- 2.1. FSCO 's priorities and strategies are the same as that contained in its final Statement of Priorities & Strategic Directions dated June 2011 ("2011 Statement of Priorities").
- 2.2. FSCO has set out a number of initiatives to operationalize its strategies and has also set out a number of strategic outcomes it hopes to achieve. FAIR Canada welcomes the opportunity to provide its comments on FSCO's initiatives and strategic outcomes and to provide our recommendations to improve regulation for the benefit of financial consumers.

3. Add Initiative - Improve Communication with and Accountability to Consumers

- 3.1. In furtherance of its legislative mandate to provide regulatory services that protect the public interest and enhance public confidence in the sectors it regulates, one of FSCO's strategies is to "communicate, share knowledge and engage our staff and stakeholders". **FAIR Canada recommends, as it did last year, that FSCO undertake a specific initiative to further the ways in which it communicates with and is accountable to financial consumers.** FSCO should set as a specific initiative means of obtaining the views of financial consumers, in order to understand their concerns and be accountable to their interests.
- 3.2. FAIR Canada notes that consultations that are undertaken by insurance regulators receive substantial feedback from insurance companies, insurance industry associations (such as the Canadian Life & Health Insurance Association, The Financial Advisors Association of Canada (Advocis) and the Independent Financial Brokers of Canada), and individual insurance intermediaries but little, if any, response from financial consumers. The interests of insurance

companies, managing general agencies and insurance agents are often different (or even in direct conflict) with those of financial consumers. Clearly there is an asymmetry in stakeholder representation in the policy-making process that needs to be addressed. Regulators and governments pursuing reforms would benefit from the support from consumers for such reforms.

- 3.3. **FAIR Canada recommends one means of obtaining the views of financial consumers would be through strengthening the Consumer Advisory Committee (the “Committee”) which FSCO created in 2001.** The mandate of the Committee is to provide advice from the consumer’s perspective on matters that affect FSCO’s regulated sectors⁴ and the Committee is to serve as FSCO’s principal consultation vehicle with consumers⁵. The Committee’s role when it was launched included providing advice to the Superintendent of Financial Services on matters of interest to consumers, providing a consumer’s perspective on consultation documents and undertaking specific initiatives designed to assist consumers in respect of the purchase of financial products. The Committee should not be restricted to commenting on FSCO’s proposals or consultation documents but should be able to provide FSCO with its views on matters of concern to consumers that affect FSCO’s regulated sectors. FAIR Canada noted in its submission last year that the Consumer Advisory Committee has not provided any written submissions that are available publically since its inception. We understand that it has provided comments through quarterly discussions with FSCO. The lack of any written submissions is likely due to the limited resources provided to the Committee and the fact that the Committee members are not paid for their time.
- 3.4. **FAIR Canada recommends that the Committee be provided with greater resources and its members be compensated for their time and effort in meeting the Committee’s mandate, in a manner similar to the Ontario Securities Commission’s Investor Advisory Panel so that that the Committee can provide more meaningful consumer input to FSCO that is transparent to the public.** Otherwise, the Committee will not have the ability to communicate with individual consumers, conduct any research of its own, or, it appears, prepare written submissions.
- 3.5. The Consumer Advisory Committee should also enhance its transparency by having its own web page on a prominent part of the FSCO web-site which provides information as to its current members, the dates and summaries of its meetings and other information as to its issues, priorities, goals and current operations and initiatives.

4. Add Initiative – System to Conduct a Comprehensive Background Check is Needed

- 4.1. **FAIR Canada believes that there is a real need for a single, comprehensive search function that would allow investors to check the regulatory background of a potential agent or life insurance agency or managing general agency. The current process of verifying that a potential agent is registered and has a good disciplinary history is unnecessarily complex and confusing for consumers.** Even when consumers are aware that they should “check” the registration information of a firm or individual, the complexity of the regulatory regime and the fact that multiple sources must be consulted can make background checks, or even determining whether someone is registered or not, a difficult and confusing exercise for a consumer. It is not practical to ask the average Canadian consumer to navigate through the complexities of the current system to locate the basic information they need.

⁴ See the press release of FSCO dated July 6, 2011 at <http://www.fSCO.gov.on.ca/english/pubs/news/archived/20010706-committee.asp?view=print>.

⁵ See FSCO’s Annual Report 2001-2002.

- 4.2. **FAIR Canada recommends that Canadian insurance regulators provide an informative, comprehensive, “one-stop” national system for investors to check registration and background information (including proficiency and disciplinary history) for all insurance agents, brokers, life insurance agencies (whether managing general agencies or otherwise) registered with insurance regulators and to identify non-insurance licenses for individuals licensed under other regulatory regimes such as securities (or, as a first step, a link to that information).** This system should include plain language explanations of the information provided and be searchable under business names as well as proper legal names. **Additionally, we recommend that the system provide assistance to investors who do not have access to the internet and those who are not computer-savvy.** One phone number where a consumer can call to have the relevant information explained would be an important element of such a system.
- 4.3. The CCIR in its recently released Position Paper on Managing General Agencies⁶ indicates that stakeholder submissions showed strong support for a centralized cross-Canada database documenting misconduct. The Position Paper states “[T]his would assist both insurers and MGAs as they consider the suitability of new applicants for contracts as well as assisting consumers to make informed decisions about their advisors. CCIR has formed its Disciplinary Information Committee to look into the feasibility of such a database.”⁷
- 4.4. The CCIR’s comment suggests that such a database will also assist regulators in keeping persons who have been sanctioned and banned by provincial securities regulators or other provincial insurance regulators (due to behaviour that has resulted in consumer harm) from continuing to work as an insurance agent by moving to another province (whether for another insurance company or through a managing general agency). **We urge FSCO to urgently address the ability of an insurance agent or insurance agency to continue to provide product recommendations and “advice” to consumers as an insurance agent or insurance agency if it has been sanctioned and banned by another provincial insurance regulator or a provincial securities regulator**⁸.

5. Initiative - Conduct Life Insurance Product Suitability Reviews

- 5.1. FAIR Canada notes that this was an initiative set out in its 2011 Statement of Priorities. The 2011 Statement of Priorities noted the complexity of insurance products and the lack of financial literacy of many consumers which poses risks for consumers. It noted the key role played by insurance agents and companies “...to ensure these consumers are empowered to make informed decisions and are presented with suitable product recommendations.” The focus of the upcoming review, according to the Draft Statement is to “...understand and assess the processes life insurance agents use in making recommendations to consumers and the processes in place at life insurance companies when developing and distributing products.”
- 5.2. FAIR Canada noted in its submission last year that many segregated funds and other life insurance products with investment components are complex. FAIR Canada agrees that many consumers will have difficulty in understanding them and that this creates a risk for consumers. **A timely review of the product suitability process needs to be conducted. In addition, FAIR Canada**

⁶ 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-ccrra.org/en/init/Agencies_Reg/MGA%20position%20paper%20final%20EN2.pdf.

⁷ Canadian Council of Insurance Regulators Position Paper at 8., “.

⁸ See FAIR Canada Newsletter on the topic, dated August 2011, available online at <http://archive.constantcontact.com/fs070/1102284477892/archive/1107399885184.html>.

believes that a substantive assessment of the adequacy of the process and recommendations to improve it are overdue.

- 5.3. FAIR Canada would like to see some detail regarding the approach and scope of the market conduct review that will be conducted by FSCO in order for FSCO to obtain a better understanding of what is typically done by an agent to ensure suitability of product recommendations. **In the interest of transparency, and effectiveness, FAIR Canada recommends that FSCO include in its final Statement of Priorities details on the proposed approach. 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 consumers⁹.**

Suitable Product Recommendations – Regulatory Requirements Needed

- 5.4. FAIR Canada reiterates the need for FSCO, as part of the product suitability 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.
- 5.5. 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.
- 5.6. FAIR Canada urges FSCO to assess, when conducting its product suitability review, whether consumers are, in fact, being provided with suitable product recommendations and whether this process has been adequately documented. FAIR Canada assumes that FSCO will be conducting the product suitability review taking into account The International Association of Insurance Supervisors’ in the Core Principles, Standards, Guidance and Assessment Methodology in October 2011 (the “ICP”), and in particular, ICP 18 and ICP 19 (including 19.6).
- 5.7. **FAIR Canada recommends that FSCO consider setting out *regulatory* requirements insurance agents to meet so that suitability is properly determined before recommendations are made for clients. We recommend that the requirements for product suitability be similar to IIROC Dealer Member Rules 1300 and 2500 and MFDA Rule 2.2.1 and Policy No. 2. 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 suitable¹⁰. This poses real risks for consumers and needs to be addressed.**
- 5.8. There continues to be increasing convergence between products offered in the insurance and securities sectors. Regulators must ensure that consumers are adequately protected regardless of

⁹ 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>.

¹⁰ Position Paper at 9-10.

which sector of the financial services industry the product or sale originates from. Fairness would suggest that the rules for determining what funds are suitable for the consumer should be equivalent. This is especially true since the access point for the sale of these products is often the same individual financial services provider (the dually licensed salesperson) and can even involve investment in the same mutual funds (with a 'wrap' product).

- 5.9. **FAIR Canada recommends that FSCO add as a Strategic Outcome from the above-noted initiative, "Increased Compliance with Product Suitability Requirements".**

Unsuitable Recommendations to Borrow to Invest

- 5.9. FAIR Canada is concerned that many financial consumers are being inappropriately encouraged to borrow to invest and that there are inappropriate contractual relationships between registered firms, companies that provide mutual funds or segregated funds, and financing companies to provide preferential rates on investment loans to consumers. Specifically, FAIR Canada is concerned that leverage is being recommended to be used to invest in mutual funds or segregated funds, which we view to be inappropriate in the many cases.
- 5.10. **FAIR Canada recommends that FSCO add to its product suitability review, an examination of the prevalence of recommending borrowing to invest, particularly focusing on segregated funds.** In our view, there should be a presumption that leveraged investing is unsuitable for retail investors, particularly with respect to the sale of segregated funds, mutual funds and similar collective investment funds, and it should be up to registrants who encourage this practice to prove that such an investment strategy is suitable for that particular investor. FAIR Canada has written to the CSA to raise this issue, stating that current suitability requirements do not provide adequate investor protection with respect to leveraged investing. This should also be examined by FSCO given that insurance agents are also recommending borrowing to invest¹¹. The extent of the problem on the insurance side is not clear given that there is no complaint statistics in OLHI's 2011 Annual Report on complaints related to segregated funds, or the inappropriate use of leverage.

Investors Need to Understand the Product, Its Associated Risks and Costs

- 5.11. FAIR Canada believes that more needs to be done in order to adequately protect consumers of complex financial products. FAIR Canada believes that regulators need to ensure that retail investors are not sold a product, particularly a complex product, unless the intermediary is satisfied, based on objective evidence, that the financial consumer actually understands the product and its associated risks and costs. Simply increasing the volume of information disclosed to consumers will not provide adequate protection. The provision of lengthy, complex and legalistic documents (for example, a 200 page Information Folder for a segregated fund contract) will not be effective for investor protection. FAIR Canada believes that regulators must take a more proactive role and use substantive measures to protect consumers. FAIR Canada advocates for the adoption of a new model of consumer protection for complex financial products, including segregated funds. This new model would place the burden on parties who sell complex financial products to consumers (meaning insurance companies, distributors and agents) to ensure that their sales force, clients and the end consumer actually understand the products being sold, the associated costs, fees and risks, and the implications of the disclosure documents provided. **In**

¹¹ See Globe and Mail article "Terrible financial advice –available at a location near you", by Ted Rechtshaffen published November 14, 2011; available online at <http://www.theglobeandmail.com/globe-investor/personal-finance/ted-rechtshaffen/terrible-financial-advice-available-at-a-location-near-you/article2234183/>.

other words, FAIR Canada advocates the replacement of a standard of informational disclosure with a standard of active knowledge.

- 5.12. This will require insurance companies and intermediaries to reach out to their clients and build their knowledge and understanding of the products in question. This approach will help protect the interests of consumers in a market of sophisticated financial products and help to ensure that clients' best interests are put first.
- 5.13. This approach will support consumer protection by promoting financial awareness. FSCO, states in its Draft Statement that, as part of its review of the suitability process, it "...will consider the actions life insurance agents and companies are taking to support the financial literacy of their clients." **The product suitability review should consider the steps taken to address the asymmetry of information between well-resourced, sophisticated insurance companies and their insurance agents, and their unsophisticated consumers.**
- 5.14. The International Association of Insurance Supervisors' ICP states that "[A]t the heart of consumer protection are asymmetries of information between financial services product providers and the public to whom the products are sold".¹² ... "The enhanced financial awareness of consumers is a further means of ensuring that consumers are aware of the products available to them and **understand their purpose, how they work and their key features, including cost.** This understanding helps consumers to compare products and to purchase insurance products that meet their needs".¹³ (our emphasis) Thus, the review should focus on the steps taken to address the asymmetry of information and ensure that consumers understand the recommended product, its key features, including fees (including commission, both direct and indirect) and costs.

Pre-Requisite Qualifications Need to Be Improved

- 5.15. The prerequisite qualifications that are required in order to sell financial products, particularly complex financial products such as segregated fund contracts, should also be examined to determine whether higher standards are necessary in order to protect financial consumers. The ability of agents to support the financial literacy of their clients depends on the proficiency, knowledge and skills of the agent. At present, agents simply need to write and pass the LLQP in order to sell complex products such as segregated funds. They do not need to have a high school diploma. FAIR Canada does not consider this to be adequate given the complexity of financial products, and the degree of unconditional trust and confidence that is placed in financial service providers¹⁴. As noted by the ICP, "[M]ore complex products or customer needs will require higher or more specialized qualification and experience."¹⁵ **FAIR Canada recommends that FSCO consult with stakeholders on increasing proficiency standards for insurance agents.**
- 5.16. It is important that FSCO and other insurance regulators develop a system to ensure that agents have attained the appropriate level of proficiency to provide the services that they offer. Consumers need to have the means to evaluate the education, certification and training, as well as experience, of any registrant from whom they consider obtaining advice.

Dual-licensing is Required to Protect Consumers

¹² Supra, note 1 at paragraph 18.0.18.

¹³ Supra, at paragraph 18.0.19.

¹⁴ See the OSC Investor Advisory Panel's submission on the Ontario Securities Commission's Draft Statement of Priorities at http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20110427_11-765_ananda.pdf.

¹⁵ Supra, at paragraph 18.3.3.

- 5.17. In order to ensure that suitable products are recommended to a client, FAIR Canada urges FSCO to only permit agents to sell segregated funds if they can also offer the client mutual funds and other financial products which have lower fees. A segregated fund contract will not be a suitable product for many financial consumers and other products may very well be more suitable. Nonetheless, the agent who is not dually licensed will be incented to sell the segregated fund contract, even though mutual funds or other products may be more suited to the needs of the client, since they are not able to sell those products. Some insurance companies have recognized this issue and only allow an agent to sell segregated funds if they are also licensed to sell mutual funds. **FAIR Canada recommends that FSCO make it a regulatory requirement, that in order to sell segregated funds, the agent should also be licensed to sell mutual funds or other lower costs products.**

Clients' Best Interest Standard

- 5.18. In order to improve fairness and protection for investors, FAIR Canada recommends that FSCO undertake to propose a **regulatory** requirement that all market intermediaries including insurance agents put their clients' interests first. ***We recommend that FSCO add as a specific strategy the issuance of a consultation paper in 2012 on implementing a "best interest of the client" standard for all market intermediaries.*** The Ontario Securities Commission (the "Commission") in its 2011 Statement of Priorities undertook to research the pros and cons of imposing a fiduciary duty on financial advisors and indicates in its draft 2012 Statement of Priorities that its research will be completed and a paper on the adviser's duty to clients will be prepared and published in consultation with the CSA¹⁶. We believe that FSCO should also undertake such a consultation at the same time, in light of the fact many insurance agents also sell mutual funds and other investment products.
- 5.19. FAIR Canada believes that financial service providers should be providing recommendations that are not just "suitable" or meet the client's "identified needs" but are also in the client's best interests. While the IPRC put forth the principle-based recommendation of priority of the client's interest – that all insurance intermediaries must place the interests of insurance policyholders and prospective purchasers ahead of his or her own interests - this does not accord with the actual sales practices of the insurance industry or the product suitability principle. Ensuring that a product is suitable for the client does not necessarily mean that it is in the client's best interests, especially since there are frequent misalignments of interests between the financial service provider and the clients, given how financial service providers are compensated and incentivized to sell products.
- 5.20. Many investors believe that their advisor already has a duty to act in their best interests or has a fiduciary duty but there is no clear legal obligation that advisors are bound by any fiduciary obligation¹⁷. This creates obvious risks for financial consumers.
- 5.21. FAIR Canada is supportive of clearer disclosure to consumers, particularly with respect to costs and fees, including transparency as to the amount of commission or other compensation in relation to the sale of a product to a consumer. However, such disclosure may not be sufficient. Academic evidence indicates that disclosure in isolation does not always serve its intended purpose, and can lead to unexpected and undesirable advice and consumer behaviour, especially

¹⁶ OSC Notice 11-753 (Revised) – Notice of Statement of Priorities for Financial Year to End March 31, 2012 (2011) 34 OSCB 6694 and OSC Notice 11-766 – Statement of Priorities – Request for Comment Regarding Statement of Priorities for Financial Year to End March 31, 2013 (2012) 35 OSCB 3007 at 3011.

¹⁷ Supra, note 2 at page 4 to 5.

when it comes to the disclosure of a conflict of interest.¹⁸ FAIR Canada believes that a best interest standard must be introduced in order to protect consumers, and urges Canadian regulators to do so promptly to keep pace with other leading international jurisdictions.

- 5.22. FAIR Canada believes that it is crucial that Canada not fall behind other jurisdictions in consumer protection; the U.S., the U.K., Australia and other leading jurisdictions have moved ahead of Canada in their initiatives to strengthen investor protections within the client-financial advisor relationship. These jurisdictions are much further ahead in instituting a fiduciary duty or duty to act in the best interests of the client, by banning conflicted remuneration structures such as embedded commissions and volume-based payments and prohibiting the use of the terms “independent” or “unbiased” by a registered person, if that registered person is in receipt of commission or volume-based payments.
- 5.23. FAIR Canada urges FSCO to take heed of regulatory developments in other jurisdictions, both in respect of insurance and securities, in order to adequately protect financial consumers of insurance products and services¹⁹.
- 5.24. The CCIR’s Position Paper identified the issue that “Although the CCIR Principles for Managing Conflicts of Interest form part of industry codes of conducts and are the responsibility of the insurance agent whether or not an MGA is involved, consumers seem to want additional reassurance that they are receiving competent product recommendations and advice that is free from conflict of interest.” **FAIR Canada recommends that the adequacy and appropriateness of the CCIR Principles for Managing Conflicts of Interest be reassessed in light of the evolving international standard.**

6. Initiative - Amendments to the Insurance Act

- 6.1. The Draft Statement indicates that the Ontario government announced in the 2012 Ontario Budget that it would be proposing amendments to the life insurance and accident and sickness insurance parts of the Insurance Act to enhance consumer protection, reduce regulatory burden and harmonize with other jurisdictions. Provisions dealing with insurance distribution are to be included. This is the first overhaul these parts of the legislation relating to life insurance and accident and sickness insurance since 1962. This review was also mentioned in the 2011 Statement of Priorities.
- 6.2. **FAIR Canada urges FSCO to consult with all stakeholders when considering legislative change so that consumer and retail investor advocates have an opportunity to provide their input into the policy-making process.** FAIR Canada believes that FSCO and the Ministry of Finance should consider, among other things, the following legislative provisions:
 - product suitability and/or a best interests of the client legislative requirement;
 - the requirement to disclose to the consumer the amount of compensation and incentives in relation to the sale of a product in order to have a transparent relationship between the financial consumer and the financial services provider;

¹⁸ Cain, Daylian M., Loewenstein, George and Moore, Don A., “The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest” (2005) 34 J. Legal Stud. 1, available online: <<http://sds.hss.cmu.edu/media/pdfs/loewenstein/DirtOnComingClean.pdf>>.

¹⁹ The ICP notes that some jurisdictions have in place or under consideration the prohibition on certain types of financial interest and structural changes to the retail distribution model, such as by prohibiting the payment or receipt of commission on investment products in favour of a fee-based approach along with managing or prohibiting “soft” commissions. See *supra*, at 18.5.17 and 18.5.18.

- provisions to improve cost and performance reporting for insurance products with an investment component;
- specific provisions which address referral fees;
- specific provisions to address the splitting of commissions; and
- legislative changes to address the role and responsibilities of the Managing General Agency.

7. Examine CCIR Recommendations Regarding Distribution of Insurance

- 7.1. FSCO indicates in the Draft Statement that it will review recommendations made by the CCIR regarding the Managing General Agency (MGA) distribution channel and associated issues. The Position Paper was released by the CCIR in May, with comments due June 1, 2012.
- 7.2. The MGA channel has developed into the dominant distribution channel in the last ten years. The CCIR's Issue Paper released February 9, 2011 sought to obtain clarity as it relates to the roles, responsibilities, accountabilities, and appropriate oversight of the agent, the MGA and the insurer. It dealt with a number of important areas such as:
- the supervision of agents (both initial screening and ongoing monitoring of conduct);
 - responsibility for detecting and reporting unsuitable conduct of agents and the difficulty of doing so given the structure of the MGA channel;
 - the level of transparency to consumers of compensation structures of advisors and MGAs and whether there are misalignments of incentives taking place;
 - how complaints are dealt with by the agent, MGA and insurer; and
 - whether the existing OmbudService for Life and Health Insurance ("OHLI") has too narrow a mandate as only insurance companies, but not those who distribute insurance – such as MGAs and agents – are required to participate in OLHI. For example, complaints about an advisor's activities do not fall within the scope of OHLI and, therefore, the consumer on the insurance side does not have access to the same free, non-binding comprehensive dispute resolution service as he or she does on the securities side with the Ombudsman for Banking Services and Investments ("OBSI").
- 7.3. The goal of the consultation was to determine whether there are regulatory gaps and risks to consumers and whether, given the changes in the distribution model and the changes in the marketplace that have occurred, the regulatory framework must change to ensure that the regulatory goals of fair treatment to consumers and compliance with laws can be met.
- 7.4. FAIR Canada reviewed the submissions that were posted on the CCIR's website and notes that the CCIR did not receive any written submissions from individuals who are not affiliated with the insurance industry nor did it receive any comments from non-profit organizations who seek to protect the interests of consumers. **FAIR Canada recommends that FSCO and the CCIR reach out to consumer-based organizations, if they have not already done so, to obtain the views and perspectives of the consumer when determining whether there are any regulatory gaps or risks to consumers, and in respect of any recommendations or proposed changes to the regulatory framework.** It is essential to an effective policy-making process that financial

consumers are consulted and their input is received. Sufficient funding should be provided to the Committee in order to allow it to provide written comments. FSCO and the CCIR, and Ministry of Finance officials, should take proactive steps to obtain the consumer perspective on the CCIR's Position Paper and any proposed reforms to the Insurance Act, given the importance of the areas addressed and the issues identified.

- 7.5. FAIR Canada notes that the CCIR's description of the risk-based approach to market conduct regulation in the Position Paper does not include any explicit consultation with consumers or consumer groups and involves consulting first with industry and assessing the quality of the industry response. FAIR Canada suggests that consulting with industry and with the Committee and other consumer groups at the same time would allow a more balanced approach and lead to more effective policy-making.
- 7.6. **A very different perspective may be obtained on an issue if consumers are consulted as stakeholders early on in the policy-making process.** For example, FAIR Canada, in its Report on a Decade of Financial Scandals, recommends that regulators and SROs should require registrants to report to a commission or SRO when they have knowledge that suggests that another registrant is engaged in unprofessional conduct. Registrants are often best placed to detect potential fraud or other misconduct by another registrant (whether individual or firm).²⁰ Reporting potential misconduct could lead to the misconduct being identified at an earlier stage and loss or damage to clients being reduced or eliminated. Therefore, on the issue of whether MGA should be required to report misconduct to the regulator (or only to the insurer), FAIR Canada would not agree with the view in the Position Paper that "ARC [the Agencies Regulation Committee of the CCIR] believes that if there is an obligation to report misconduct to the insurer under the MGA-insurer agreement, and an obligation for the insurer to report to the regulator, there is no need to have both parties report to the regulator the same unsuitable behavior."²¹
- 7.7. FAIR Canada is of the view that the detection of unprofessional or wrongful conduct would be enhanced by requiring MGAs, and licensed agents, and licensed life agencies to report misconduct to the regulator.
- 7.8. Other issues, such as whether it is in the consumer's best interest to change the model of supervision and whether licensing of MGAs should be required, would benefit from further analysis from the consumer perspective. FAIR Canada suggests that the consensus of those who participated in the consultation is not sufficient to conclude that changing the model for supervision "...would not add significantly to the protection provided by consumers under the current model but would limit consumer choice by limiting access to the products of a variety of insurers."²²
- 7.9. Similarly, further consultation is needed regarding the handling of consumer complaints and whether the OmbudService for Life and Health Insurance ("OLHI") should be available to consumers who have a complaint against a life insurance agent who is not in the direct career agent channel, or with an MGA. FAIR Canada is aware that all too often, OLHI is not available to the consumer due to the fact that the insurer is not willing to accept responsibility for the actions of the agent in regard to the transaction at issue. Consumers will not understand why, in

²⁰ See A Report on A Decade of Financial Scandals: Fair Canada Calls for a National Action Plan to Tackle Investment Fraud, February 2011, at page 35. Available online at http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf.

²¹ Position Paper at 8.

²² Position Paper at 8.

respect of some matters, OLHI is available, and not in respect of others. Many consumers are also unaware of the existence of OLHI.

- 7.10. FAIR Canada believes that consumers would benefit from having the area of consumer redress for insurance product-related complaints reviewed against Canada's obligations under the G20 High-Level Principles on Financial Consumer Protection, and the ICP, and what are the current practices and standards in other leading jurisdictions and other relevant benchmarks.

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 Ermanno Pascutto at 416-214-3443/ermanno.pascutto@faircanada.ca or Marian Passmore at 416-214-3441/marian.passmore@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights

Cc: Carol Shevlin, Policy Manager, CCIR Secretariat