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Re: Notice and Request for Comment – Proposed Consolidated Segregated Funds Guidance

FAIR Canada is pleased to provide comments in response to the above-referenced Consultation.

FAIR Canada is a national, independent, non-profit organization known for balanced and thoughtful commentary on public policy matters. Our work includes advancing the rights of investors and financial consumers in Canada through:

- Informed policy submissions to governments and regulators
- Relevant research focused on retail investors
- Public outreach, collaboration, and education
- Proactive identification of emerging issues.¹

A. Overview

FAIR Canada generally supports the CCIR and CISRO proposed guidance (the Guidance) for individual variable insurance contracts (IVICs). The Guidance sets a national standard for insurers and intermediaries for the design, distribution, sale and servicing of IVICs. It also creates a level playing field across Canada for IVICs, promoting consistent consumer protection and public confidence in the insurance market.

In our comments, we make two key recommendations: (1) the Guidance should strongly signal regulators' disapproval of advisor chargebacks (ACBs), and (2) CCIR and CISRO

¹ Visit www.faircanada.ca for more information.

should encourage regulators across Canada to implement the Guidance in the form of enforceable rules, where possible.

B. The Guidance Should Disapprove of Advisor Chargebacks

Conflicts of Interest

Although we generally support the Guidance, we disagree with its approach to ACBs. ACBs prioritize intermediary compensation over consumer protection. They create a conflict between the intermediary's and the client's interests, which could lead to poor customer outcomes. We believe insurers cannot effectively manage this conflict through disclosures or controls and that ACBs should be banned.²

ACBs place the interests of the intermediary and the client in direct conflict during the chargeback period. Although clients are meant to hold IVICs for an extended period, they may want or need to redeem their investment early. When this occurs, the interests of the client (who wants to sell) and the intermediary (who does not want to repay the commission) are opposed. This serious conflict risks distorting the intermediary's advice and harming consumers. The prospect of paying the chargeback could lead the intermediary to discourage the client from selling early, even if exiting may be best for the client.

Instead of disapproving of ACBs, the Guidance contemplates insurers offering them with appropriate policies and internal controls. It includes various measures to address ACBs, including:

- Insurers should offer other sales charge options (SCOs) besides ACBs;
- The compensation intermediaries receive under ACBs should be similar to what they would receive under other SCOs;
- Insurers should only raise fees relating to ACBs in a way that treats all policyholders fairly, regardless of their SCO;
- Customers should be able to withdraw some of their IVIC deposits each year without triggering an ACB;
- The chargeback period should be less than three years;
- Intermediaries should explain to the customer that they may have to repay their compensation under an ACB;
- Insurers should not offer temporary increases in intermediary compensation under an ACB option; and
- Insurers should monitor for unfair treatment of customers when they use ACBs.

While these controls are better than having none, they will not eliminate the fundamental, irresolvable conflict that arises when a client wants to sell their investment during the

² FAIR Canada also expressed concerns about ACBs in our [comment letter](#) to the CCIR dated November 7, 2022 on its Discussion Paper on Upfront Compensation in Segregated Funds.

chargeback period. The controls should be treated as temporary solutions until insurance regulators across Canada ban ACBs completely. Prohibiting them entirely would be more effective than trying to regulate a conflicted sales structure.

We are disappointed that the Guidance does not do more to discourage ACBs. The Guidance should make it clear that ACBs create significant conflicts of interest that pose serious risks to consumers. It should also state unequivocally that insurers should avoid using them.

Limits of Disclosure

One proposed control is that intermediaries should explain to customers that they may have to repay their compensation under an ACB. We are concerned that many retail investors will not fully grasp how ACBs work or may influence an intermediary's recommendations to his or her client.

Many consumers lack the financial literacy needed to understand ACBs. FAIR Canada's research showed that average investors find investing and the regulatory system hard to navigate. Participants struggled to comprehend terminology and investment documents. Despite some claiming average or intermediate investment knowledge, they could not answer basic questions about their investments.³

Low financial literacy affects consumers' ability to evaluate sales charges and how advisors get paid. Research shows that it also impacts the ability to assess fees and choose mutual funds effectively.⁴

Research has also revealed the limits of disclosure in addressing conflicts of interest. A study found that even when commission types are explained, half of the retail investors could not form an opinion about whether the commission posed a potential conflict of interest. Of those who did form a viewpoint, three-quarters believed the advisor would look out for their best interest. The researchers concluded that this belief gives investors little reason to seek alternative forms of compensation.⁵

These findings show that disclosing and explaining conflicts to the average consumer is insufficient to manage them. The better approach is to avoid conflicts altogether and ban ACBs.

Limits of Monitoring

The Guidance advises insurers to monitor for unfair customer treatment both during and for a reasonable period after any reduction in an intermediary's compensation resulting from a chargeback. Monitoring for unfair treatment is much less effective than an outright ACB ban because:

³ FAIR Canada, [Focus Groups - Understanding Canadian Investors](#), January 2024.

⁴ Edwin Weinstein, The Brondesbury Group, [Mutual Fund Fee Research](#), Spring 2015, p. 48.

⁵ Ibid.

- **Monitoring is reactive** rather than preventive—it identifies issues after they have already harmed customers;
- **Monitoring requires significant resources** and a commitment from insurers to enforce the standards; and
- **Monitoring will not detect all unfair treatment.** Subtle forms of unfair treatment might go undetected, allowing harm to persist. Without a ban, intermediaries might take calculated risks, knowing that monitoring will not catch every misstep. Banning ACBs would remove this risk entirely, enhancing consumer protection.

C. Implement the Guidance as Enforceable Requirements

CCIR and CISRO set national expectations for insurers through guidance. Each jurisdiction then decides how to adopt guidance within its legal and regulatory framework. CCIR and CISRO should encourage each jurisdiction to implement the Guidance through binding, harmonized requirements, where possible, rather than non-binding expectations.

The Guidance aims to provide comparable consumer protection for segregated funds and mutual funds because of their similarities as investment vehicles. For instance, it sets standards for know-your-client, know-your-product, and suitability, which are fundamental, enforceable obligations in securities regulation.

To achieve similar consumer protection, the standards in the insurance and securities industries should have the same level of enforceability. Different approaches for advisors selling insurance and securities—one that uses guidance and the other enforceable rules—makes little sense from a consumer protection standpoint.

Governments across Canada should consider whether insurance regulators need stronger tools, such as the authority to make binding, enforceable rules. Enforceable obligations would create a more level playing field between the insurance and securities industries, reducing the chances of regulatory arbitrage. They would also better protect consumers by strengthening accountability and providing recourse if an insurer or intermediary breaches a rule. Lastly, enforceable rules would provide greater certainty, minimizing confusion and inconsistencies in insurer practices that could harm consumers.

Thank you for considering our comments on this important issue. We welcome any further opportunities to advance efforts that improve outcomes for consumers. We intend to post our submission on the FAIR Canada website and have no concerns with CCIR and CISRO publishing it on their websites. We would be pleased to discuss our submission with you. Please contact Jean-Paul Bureaud, Executive Director, at jp.bureaud@faircanada.ca or Tasmin Waley, Policy Counsel, at tasmin.waley@faircanada.ca.

Sincerely,



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Executive Director
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