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Submitted by email: ccir-ccrra@fsco.gov.on.ca

Dear Sirs/Mesdames:

Subject: Segregated Funds Working Group Issues Paper

Independent Financial Brokers of Canada (IFB) is pleased to provide our comments on the *Issues Paper*, released May 2016.

IFB is a national, not for profit professional association representing the interests of its members for over 30 years. IFB members are licensed financial advisors who have chosen to be owner-operators of their financial services business.

IFB members believe strongly in the value of independent advice for consumers. Their ability to source products and services from a variety of insurers means they are well-positioned to address a customer's financial needs. IFB members believe in the importance of life insurance products, and their role in the provision of long-term security for individuals and families. Wealth management products, like mutual funds, certainly have their place for those who are comfortable with the higher level of risk that comes from investing. While both products can comfortably co-exist in a client's portfolio, there remain fundamental differences that cannot be ignored.

Many IFB members are licensed to sell both life/health insurance and mutual funds. Therefore, most are already familiar with the increased disclosures and level of transparency required by securities regulators through CRM2. IFB has provided education specifically tailored to the 'dual-licensed' advisor at our most recent Toronto Summit, and in a webinar which addressed the challenges advisors will face when clients hold both securities and insurance investments. As well, a section on the IFB website is devoted to CRM and CRM2 requirements. In it links are provided to various educational resources for advisors, and tools for advisors to use with clients to help explain the new statements, account performance and fees.

To better inform IFB's response to this *Issues Paper*, we asked members to provide their input by completing a survey, made up of the 20 questions posed in the Paper. Given the complexity of the questions, and their open-ended nature, we were gratified that 100 advisors took the time to respond. The comments that follow incorporate this advisor input, and we have included some direct quotes from member responses, italicized and in blue font, throughout this letter.

Current regulatory frameworks

While there appears to be a perception by some that the mutual fund sector is more strictly regulated than the insurance sector, the perception arises from the differences in regulatory models – one (securities) being prescriptive and dominated by rules, and the other (insurance) being risk or principles based. Both seek to achieve positive outcomes for consumers and the industry. In this respect, we think Canada's Joint Forum position from 1999, remains relevant today, in that the regulation of mutual funds and IVICs share similar regulatory objectives, but "because the products are based on fundamentally different legal principles … harmonization of the *result*, rather than harmonization of rules should be the goal"[1].

While anecdotal remarks are reported in the media, we have seen no empirical evidence to support that IFB members, or other advisors, are choosing to relinquish their mutual fund licenses and concentrate on life insurance sales as a result of CRM2. It is true that some advisors do give up their mutual fund license, but in our experience this is most often related to an aging broker population focused on simplifying their practice as they move toward semi-retirement. Others find the cost of maintaining multiple licenses too high, relative to the volume of business they conduct.

We urge insurance and securities regulators to be cautious in responding to allegations of regulatory arbitrage. Those few advisors tempted to engage in such a practice should not negatively impact the vast majority of advisors who conduct themselves in a compliant and professional manner. All licensed advisors are subject to their dealers, MGAs and/or insurance companies' oversight, each of which employs measures to watch for inconsistent or unusual sales transactions, and to follow-up on these red flags.

At the regulatory level, a number of undertakings are underway that will better coordinate enforcement and sharing of disciplinary information across financial sectors, and provincial/territorial jurisdictions. Examples include the various MOUs and the CCIR Framework for Cooperative Market Conduct Supervision in Canada. These commitments will assist regulators and industry in identifying, and acting early on this shared information to prevent unsuitable firms and individuals from posing a continuing risk to the public.

Disclosure (Questions 1, 2)

We agree that it is difficult to balance the need for disclosure and transparency, so that consumers better understand the products being recommended or purchased, with the potential risk that the additional disclosure will overload consumers, rendering it ineffective. In fact, our members tell us this is often the case today. Add to this that the information tends to be complex, and clients simply become disengaged.

[1] *Recommendations for Changes in the Regulation of Mutual Funds and Individual Variable Insurance Contracts*. Joint Forum of Financial Market Regulators, December 1999.

In fact, there is considerable evidence that increasing the level of disclosure of conflicts of interest in isolation may not improve outcomes for all consumers.
"The majority of existing research reviewed is based on either theoretical modeling or controlled experiment results. The external validity of the conclusions drawn from this research is an open question. For example, the monetary incentive, the cognitive load, and the decision environment are very different when people are estimating the value of a jar of coins as opposed to when they are making a financial decision regarding retirement."[2]

Currently full disclosure of fees and compensation is provided to clients via the information folder for IVICs. While the idea of enhanced disclosure may have appeal the end client has full disclosure now. More information can lead to confusion which leads to inaction. People need to save and become more self-reliant. Any enhanced disclosure must be simple and understandable and more importantly meaningful. All my clients know I get paid, they know there is an MER on the funds they invest in, they have the exact numbers for this as well as the exact percentages of compensation reviewed and provided. How their investments grow for them has and always will be more important.

Point of sale documents currently in use in both the life insurance and mutual fund sectors have been well received by our members and their clients. The Fund Facts, and the Key Facts for insurance products, have proven to be important comparative tools for advisors and clients both before and at the time of a purchase.

The CSA has developed an interactive Fund Facts document for consumers. In our view, a similar tool for IVICs would be welcomed by consumers and advisors alike. Interactive tools help consumers to be more financial literate about these products, and increases their ability to more fully participate in the financial decision-making process. Were such a tool to be developed by the CCIR, it would be viewed by consumers as unbiased, thereby increasing its effectiveness.

The focus seems to be on cost. Instead, disclosures should point out both cost and benefit! The guarantees provided have a cost, but they also have many benefits. The disclosure of one without a representation of the other is in my opinion a poor practice that will only confuse clients and dissuade potential purchasers of the many fine benefits of a seg fund. Alongside any display of costs should be an equally well thought out outline of the benefits received. For example, in BC a $1 million dollar seg fund could potentially save beneficiaries $14,000 in probate fees!

Charges and Compensation

IFB members support meaningful disclosure which provides consumers with access to sufficient information to help them decide if a risk-insured product is appropriate to their circumstances. Most insurers already have a wealth of information easily accessible to consumers on their websites. This information details the overall performance, costs and level of risk of each segregated fund.

Many members agreed that the disclosure of fees and compensation should align with that required for mutual funds under CRM2. However, they emphasized the importance for any new disclosure to:

[2] Effective Disclosures in Financial Decision-Making. Prepared for US Department of Labor. July 2015. https://www.dol.gov/ebsa/pdf/conflictofinterestresearchpaper3.pdf

- incorporate a simplified, plain language explanation; and,
- address how the insurance component of segregated funds leads to a higher MER.

Separating the cost of the investment from the insurance components would help consumers understand the higher MER often associated with IVICs, particularly when compared to the MER of a mutual fund.

With the implementation of CRM2, dual-licensed advisors are likely to provide clients with costs associated with all investments and products in their account (even products not subject to CRM2) as to do otherwise is likely to raise questions from clients expecting to see the same, or similar, cost disclosure.

Advisors noted that consumers should be required to sign disclosure documents, to acknowledge their receipt.

Brokerage and Soft Dollar Arrangements (Questions 3, 4)

The majority of respondents felt ensuring consumers were aware of soft dollar arrangements and other sales incentives could be addressed by enhanced disclosure, although this is already required in some jurisdictions. Some thought such incentives should be banned.

The question about whether insurers should make sure that soft dollar arrangements and other sales incentives do not create conflicts of interest for intermediaries is likely best addressed by regulators, perhaps through setting acceptable guidelines.

Account Performance (Question 5)

There was less support for harmonizing account performance reports with those provided by mutual funds, primarily due to the differences between segregated and mutual funds. However, this does not preclude developing a clear, simple explanation regarding the costs and benefits of the insurance protection, alongside the performance information. There was support for providing more information on the guarantee level and maturity date of the IVIC.

There are advantages to IVIC contracts and there are advantages to Mutual Fund contracts. Let their distinctions co-exist so the Customer has choices.

Product Performance (Questions 6-9)

We note that while the phrase 'long-term' is not defined, most agreed the IVICs are generally a long-term investment, subject to the client's needs, situation and ongoing suitability.

You have to look at the circumstances of each individual. Where death is potentially imminent, the fact that there are no fees at death can make it a good solution. Most of the time, the time horizon to benefit from maturity guarantees is a long one.

There was broad support for harmonization, although a significant number disagreed, citing the following reasons:

- they are different products;
- performance only captures a piece of the segregated fund value;
- it ignores the value of IVICs in estate planning, probate and the guarantees.

It depends on the investment, the investor, the suitability and the plan for that capital. I would consider seg funds to be excellent tools for planning for all time frames.

Highlight funds sold on a DSC or Low Load basis as to what those charges could be and how they work. Any early withdrawal penalties related to maturity guarantees, or GMWB payout streams.

With respect to additional data that would be of value to consumers, suggestions included focusing on the Rate of Return relative to performance, the cost/fees related to the guarantees, and estate planning information. There was support for a simple statement capturing cost, performance, guarantees, estate planning and other benefits, as well as more information on fees, early withdrawal penalties, and resets.

Disclosure upon Subsequent Fund Purchases (Question 10)

Generally respondents agreed that investors should receive updated Fund Facts upon subsequent investment in the same fund. The exception to this would be for clients who make regular monthly deposits to their investment account, i.e. the PAC exemption that exists for mutual funds should apply to IVICs as well.

A number of respondents indicated that updated Fund Fact documents may be useful for clients if there has been a material change in the fund, such as a change in management or fund objectives. However, since updated Fund Facts are accessible at any time on insurer websites, Fundata Canada, and SEDAR, simply alerting the client to a change may be an efficient solution.

Risk classification Methodology (Question 11)

We understand the CCIR's concern that risk methodology should follow an appropriate standard. The CCIR could issue guidance on acceptable ranges for risk classifications that would improve the standardization but allow for the differences the guarantees make for IVICs compared to mutual funds.

Most advisors felt this is a technical issue that is likely of interest to very few consumers. The risk classification shown on the Fund Facts is useful, and generally sufficient for the client's needs.

Sales Oversight (Questions 12-14)

The CCIR affirmed in its final position paper on the role of insurers and MGAs, that insurers are responsible for oversight of life insurance sales and distribution:

"It is important to understand that, although MGAs have become a very important component of the life insurance distribution system, this does not change the roles and responsibilities of the parties, as currently defined under the laws that apply to insurance. For example, an insurer remains responsible to the policyholder for its products by virtue of a binding contract. It does not matter if the policy was sold by a career or by an independent agent, and whether or not the independent agent was recruited by an MGA. Similarly, under the law of agency, if an insurance agent acting on behalf of an insurer is improperly monitored, this may trigger liability for the insurer regardless of the fact that the agent may act on behalf of more than one insurer, through one or various MGAs."[3]

[3] Strengthening the Life MGA Distribution Channel CCIR Position Paper. September 2012

However, it appears some of the questions raised in this section of the *Paper* deviate from this position. For example, while life insurance companies do not have an explicit statutory obligation to provide product related training, they do so to address their responsibility to ensure agents are well-informed on the products being sold, and to prevent consumers from being subject to unsuitable, or unacceptable, sales practices.

Insurance companies provide this education through their own events, at advisor conferences and through MGAs. Online training materials are available for agents to access at any time, and supplement in-person sessions. Having said this, we did see support in the survey responses for more frequent training and education of advisors. We note that we did not collect any demographic or business information in the survey, therefore, these responses may have come from advisors who work with smaller MGAs, or those in rural or more remote locations which make opportunities for in person training more difficult.

The life companies have the same role as dealers and have the ability to oversee seg sales as the paperwork is turned in to them and agent behavior is monitored. Ultimately, as they <insurers> are the issuers and marketers of the IVIC's they should be held fully accountable directly to the consumer.

I think a signed copy of the client's risk profile should be submitted with the IVIC application and someone at the life insurance company should address any anomalies.

Many provincial jurisdictions have mandatory CE requirements, although only some have mandatory training specific to segregated funds. IFB believes CE is an important element of a professional occupation, as it keeps individuals current with industry and regulatory trends, and other developments. In our view, CE should be a mandatory requirement in every provincial/territorial jurisdiction. A requirement for CE specific to segregated funds could be considered either by way of a guideline or by regulation.

We do not think that the model of regulatory oversight of advisors used in the securities industry should be emulated for MGAs. There are a number of important differences. For example, the role of the MGA is largely an administrative one, with frequent interaction between the advisor and insurer. Most MGAs do not engage with clients. Insurance companies contract with MGAs to provide certain services, but the insurer remains directly responsible to its policyholders and for those acting on its behalf. Mutual fund companies do not share a similar relationship with their investors. In addition, the securities industry is characterized by more frequent transactions in response to market fluctuations. In the life insurance industry, contracts tend to be longer-term, and often in place for decades.

An important element of consumer protection in the life insurance industry is the requirement for individual advisors and agencies to carry errors and omissions insurance. E&O allows client restitution to be made without the client having to undertake expensive legal action. For these reasons, IFB believes this should be a mandated requirement for licensees in all jurisdictions. Currently, it is not required for life licensees in some jurisdictions, and is not a regulatory requirement for mutual fund advisors.

Standard of Care (Questions 15-17)

The issue of an appropriate standard of care for advice provided to clients of financial products is the subject of considerable debate. IFB has been an active participant in the discussions around a "best interest duty" in CSA consultations, and those in Ontario looking at the regulation of financial planning and advice. It has been our view that a best interest duty will not clarify the duty of the advisor for clients, and may in fact contribute to greater confusion. While many argue that a best interest duty is not equivalent to a fiduciary duty, there is ample evidence that the terms are frequently interchanged.

Because the term 'best interest duty' is loosely defined and not well understood, it is often equated with a fiduciary duty. Although legal experts may be comfortable with the distinctions between these terms, consumers – and many others - are likely to view them as the same. How this will translate into every day practices, complaint resolution and legal challenges is unknown. It may give consumers a false sense of reliance on the standard of care owed to them, and advisors and firms may become more vulnerable to frivolous claims.

There are other complications around introducing a best interest duty that first need to be addressed. For example, how would it apply to sellers of proprietary products, for example insurers who employ career agents, and whose agents are unable to 'shop the market', or address the structural conflicts inherent in the industry (e.g. compensation arrangements).

It should be evident to an outside, objective observer that the product and specific fund chosen are compatible with the client's risk tolerance and that the compensation, sales/redemption charges, etc., have been fully disclosed, as well as any other potential incentives.

Arguably, a regulatory best interest standard of conduct exists today, as evidenced in insurance and securities legislation, harmonization of practice standards by regulators, and its history of application in common law.

We believe the CCIR principles to manage conflicts of interest address acting in a client's best interest, and are appropriate for the life insurance industry. IFB members are bound by the IFB code of ethics, which places the client's interest first, and insurance companies and other associations have similar codes of conduct.

IFB was part of the joint associations group that developed the needs-based guidance documents for the sale of life insurance. More recently an additional document has been developed by the CLHIA to address similar needs-based sales practices specific to IVICs. IFB recommends that its members always document client needs/risk assessments, along with conflicts of interest, and any 'know your client' materials. IFB members support the concept of using a KYC and KYP, but were clear that these documents alone are not sufficient to address IVICs, or any life insurance products, because of the different information required to purchase life insurance, such as a more detailed risk assessment, and financial assessments (relative to the client's ability to afford the insurance premium).

I think in the insurance industry we need our own information. We need more and better information. How often does a Mutual Fund Registrant ask about the client's health? How often do they ask about ability to pay and sustainability?

With regard to question 17, most IFB members said they update client information at intervals varying from annually, to every 2 years, or depending on the type of policy contract sometimes longer. However, there was general acknowledgment that more frequent contact would be required in the event of a material change in the client's circumstances, and that this would trigger a review of the client's holdings. Interestingly, a number of respondents emphasized the need for a solution to address the shared responsibility of clients in keeping their information up-to-date. Advisors sometimes deal with clients who, for personal or confidential reasons, do not wish to have a complete risk assessment done, or refuse to provide detailed information, or refuse to respond to repeated attempts by the advisor to contact them with important policy information. Such circumstances can create risk for the advisor. However, advisors also indicated that, depending on the product purchased, clients also want to have some flexibility in deciding on the amount of detail they must divulge.

Conclusion

We conclude with a few comments from survey respondents relative to the final questions in the *Paper.*

<Mutual funds and segregated funds> are NOT the same product. You might as well compare GICs to Mutual Funds. Round peg in square hole is what's happening here.

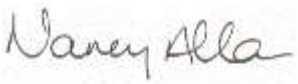
The question implies that IVIC customers are being treated unfairly, which I would entirely dispute. Yes, a very modest amount of additional disclosure and oversight would help mitigate some problems, but by and large the industry already does a good job with clients and a wealth of information exists for the clients who really want to be well informed of what they purchased and tracking performance.

I really don't think harmonization should be the goal. Looking after the client's best interest should be the goal.

IFB looks forward to discussing these issues further with the CCIR. The financial services industry is an important one, and advisors play a key role in it. IFB members spend many hours helping clients plan for, and put into place, strategies to help them achieve a stable financial future. They are valuable partners in the financial education of clients. Independent advisors, like IFB members, bring the additional element of providing clients with advice related to a range of life insurance products. We trust we have conveyed the value they place on their client's well-being.

Thank you for the opportunity to comment. Please contact the undersigned, or Susan Allemang, Director Policy & Regulatory Affairs (email: sallemang@ifbc.ca), should you have any questions.

Yours truly,



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