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December 14, 2015

Expert Advisory Panel,
FSCO/FST/DICO Mandate Reviews
Ontario Ministry of Finance
Financial Institutions Policy Branch (FIPB) &
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Re: The *Preliminary Position Paper* of the Expert Committee Reviewing the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario

Dear Sirs/Mesdames,

We are writing in response to the publication of the above-noted document.

On November 4, 2015, the Expert Committee assigned by the Ontario Ministry of Finance to review the mandates of the Financial Services Commission of Ontario (FSCO), the Financial Services Tribunal (FST) and the Deposit Insurance Corporation of Ontario (DICO) released its *Preliminary Position Paper*, which outlined the Expert Committee's initial conclusions and tentative recommendations. It therefore represents the latest stage of a comprehensive review of the way the Ontario government regulates the province's financial services industry.

Advocis' submission is in two parts. The first part addresses two general areas of concern for Advocis; the second offers a more detailed consideration of several of the 37 specific recommendations made by the Expert Committee.

CONCLUSIONS AND EXECUTIVE SUMMARY

It is time for a new approach to the market conduct of consumer facing intermediaries

The global financial crisis and various mis-selling scandals in the United States of America, the United Kingdom, and Australia, have led regulators in the Anglo-American legal sphere to reflect more critically on the relationship between the financial services sector and retail level consumers of financial products and services – and how to make the former provide more effective service to the latter. With so many jurisdictions throughout the G20 having introduced more stringent prudential regulatory requirements, the focus has now shifted in part to new ways of regulating market conduct risk. While structural reform in both the prudential and market conduct arenas – typically in the form of legislative and regulatory instruments – are necessary aspects of any regulatory reform, many stakeholders are now concluding that, in the face of what Mark Carney has termed "ethical drift" – formal regulation of market conduct and "lip service" to codes of conduct are clearly not sufficient to the tasks at hand. In fact, there is a growing recognition that, in regard to intermediaries who deal with clients at the retail level, mere proclamations of probity and avowed commitments to upholding the public trust must now be paired with appropriate standards of proficiency and conduct and with effective monitoring mechanisms regarding licensing and education.

Advocis believes that, at the fundamental level of the financial advisor and the consumer, inculcating cultural and ethical norms and introducing higher professional standards are at least as significant as reforming regulatory structures and instruments. As the Australian government stated this past October, "We will do more to lift the standards of financial advisers, including by placing this activity on a professional footing for the first time… "new obligation[s] will be principles-based rather than prescriptive and should be viewed as workable by the industry."[1]

In a similar vein, a prominent European Union financial services lawyer recently published bold observations regarding the need for a new approach to market conduct risk. He noted that in-house lawyers and compliance officers, in regard to routine behaviour such as "when a proper policy is written, a code of conduct is sufficiently communicated, or training has been made and certified" tend to think that their work is done; "they naively believe that the behaviour of their staff follows their rational thinking." This way of thinking is "a fallacy and a trap" and can "stand in the way of efficient and effective risk management." Instead, he argues, effective management

[1] Australian Government, *Improving Australia's Financial System: Government Response to the Financial System Inquiry* (Commonwealth of Australia, Canberra, October 20, 2015), p. 7.

of the behaviour of intermediaries requires – both internally on the part of the firm and externally on the part of the regulatory authority – recognition that we are now on a "new frontier," one which requires a new approach to market conduct and legal and compliance risk controls.[2]

It is just such an approach to the market conduct of intermediaries which appears to be missing from the Expert Committee's proposed regulatory framework. This is, perhaps, inevitable, given the rather high level of abstraction at which the committee is operating in its *Preliminary Position Paper*. What follows is a summary statement of what Advocis believes the Expert Committee should now consider by way of supplementing and filling out its proposed regulatory framework.

Effective regulatory reform for Ontario's changing financial services environment must include a holistic means of regulating in and across financial sectors at the consumer level

It is time to provide the consumer with an access point to Ontario's regulatory framework which opens across all financial sectors

First, a pair of observations, ones made from the perspective of the individual, everyday Ontarian: first, that the needs and concerns of a consumer of retail financial products effectively bypass or transcend any one financial industry sector, and also transcend that sector's largely-product focused regulatory authority. By this we mean that the consumer's subjective experience does not easily fit within the current regulatory framework, especially when it comes to the provision of financial advice and its regulation.

Second, Ontario's financial consumers still face a less-than-acceptable complaints-handling processes, one which too often reveals to the bewildered consumer complainant the frustrating and disjointed relationships between complaint-handling institutions and forums, the intermediary firm, and the individual advisor. Taken together, these observations indicate that there is a pressing need to implement a solution which works *from the consumer's perspective*. Such a solution must require that all industry stakeholders who deal with financial consumer issues are positioned in a regulatory system which, in its structure and mandate, presents to the financial consumer a coordinated and coherent treatment of his or her financial and regulatory experience and concerns.

[2] Peter Kurer, "Legal and Compliance Risk in a Globalized World: Nemesis or Catharsis?," *Compliance Elliance Journal* (August 2015). Kurer should know whereof he speaks: after a career in legal and compliance risk management, he served as chairman of the UBS bank during the crisis of 2008–2009. Online at http://nbn-resolving.de/urn:nbn:de:bsz:15-qucosa-176506.

Advocis is therefore pleased to note that the high-level framework set out in the Expert Committee's *Preliminary Position Paper* indicates that the Ontario Ministry of Finance is quite possibly moving towards such a regulatory system. But a significant omission remains unaddressed in that framework, which is the need to: (1) formally regulate in a consistent, cross-sectoral manner the advisor-client relationship, and (2) the nature and quality of the financial advice provided to Ontario's consumers.

We believe that the most effective way to have ongoing regulatory cooperation and contributions from individual, client-facing intermediaries – including broad-based input from advisors on the entire range of retail-level financial products available in Ontario – is to recognize advisors on a *professional level*. There seems little point in establishing a permanent consumer panel or office without hearing from the other party who participates in the advisor-client nexus. In the end, effective and efficient regulation is almost always *inclusive* regulation.

Ontarians need and deserve the assurance that their financial advisors consistently adhere to minimum standards of conduct. They further deserve the ability to access a consistent, unified complaint-handling process. Unfortunately, at present Ontario's advisors and financial consumers are immersed in an outdated paradigm, one based on the belief that self-governing and/or professional industry associations can only function *within* a single and contained sector. In a world of converging products and holistic financial advice, the time has come for a more unified and holistic approach to the advisor-client interaction.

Much of Ontario's current regulatory framework was established when individual consumer-facing intermediaries – whether by choice or design – tended to be restricted in the number of licences they held. But this fragmented financial services marketplace, with its discrete sectors of insurance, securities, etc., has, for the purposes of the consumer and of the intermediary – long since passed into history. Consumers now face a highly interconnected and often rapidly evolving financial services environment.

The integrated regulatory system proposed by the Expert Committee demands – at the retail level – an integrated treatment of the relationship between the consumer and the intermediary who serves her. Delegating administrative authority over some aspects of advisor regulation to a professional body of advisors would effectively respond to this demand. A delegated administrative authority or DAA would represent an integrated regulatory response, one which would through its mandate and resources be able to effectively promulgate the necessary minimum standards of advisor education and conduct, and efficiently conduct appropriate

monitoring, licensing, and enforcement activities.

A DAA would function as the mechanism for providing holistic regulation at the retail consumer level, and provide Ontario's financial consumers with a single point of access to the province's financial regulatory framework, one which cuts across all financial sectors. It would, ultimately, greatly assist the Ontario Ministry of Finance in fulfilling its mandate to protect the public interest. In short, effective regulation at the retail level of often-interrelated financial intermediaries which operate across industry sectors (e.g., insurance subsidiaries of retail banks, or advisors who sell both insurance and mutual funds) now requires a consolidation and rationalization of regulatory resources at the consumer level. Doing so will better position Ontario to be able to address current and anticipated future trends.

PART ONE: THE POSITIONS OF THE EXPERT COMMITTEE AND ADVOCIS ARE COMPLEMENTARY, NOT CONFLICTING

1. The relationship between the proposed Financial Services Regulatory Authority (FSRA) and a Delegated Administrative Authority (DAA): Advocis believes that the vision of enhanced consumer protection and more efficient market regulation set out by the Expert Committee in its *Preliminary Position Paper* is not at odds with but in fact is complemented by Advocis' own vision of advisor professionalization. A DAA for consumer-facing, individual financial service practitioners, such as life agents, would operate mainly by way of a principles-based approach, although administrative tasks such as the registration of individual financial advisors would be a rules-based matter for the DAA to conduct and enforce. Such a DAA would entail the recognition and regulation of the relationship between the financial advisor and the Ontario consumer. It would supplement (but in no way supplant) today's rule-based, transaction-driven regulatory model – which focuses almost exclusively on financial products – with a new and largely principles-based focus on the pressing consumer protection concerns of Ontarians.

2. The FSRA and the future of FSCO-style regulation. Advocis is concerned about the possible demise of effective, efficient insurance regulation in Ontario. The regulatory expertise developed by FSCO through decades of working with industry stakeholders would very likely be swallowed up by the proposed FSRA, and FSCO's principles-based approach to the regulation of insurance could be replaced by a securities-style, rules-based approach, one which is not needed or even appropriate for the sale of the vast range of products and services offered by a licensed life agent.

PART TWO: THE EXPERT COMMITTEE'S 37 RECOMMENDATIONS

1. Policy Formation: *Recommendation 28* states that the "FSRA should be required by statute to take a risk-based and outcomes-based approach to regulation, through which the policy objectives and likely outcomes are considered and explicitly articulated." In order to better assess the merits of the proposed FSRA, Advocis would like to see the terms "risk-based regulation" and "outcomes-based regulation" defined, along with a contextual explanation of their role in the FSRA's regulatory philosophy, particularly with regard to market conduct concerns. We note that the term "principles-based regulation" (PBR) is absent from the Expert Committee's *Preliminary Position Paper* and query whether that omission should be taken to mean that the proposed FSRA would abandon in part or in whole FSCO's long-held commitment to PBR.

Advocis' recommendation is to preserve principles-based, outcomes-focused regulation. Advocis believes that the principles-based regulatory approach of FSCO should be continued with regard to the activities of life-licensed financial advisors, and that wherever possible, rules should be drafted with an eye to flexibly guiding intermediaries towards preferred outcomes. We advocate for a regulatory approach to the supervision of individual consumer-facing intermediaries which relies on principles and outcome-focused rules, rather than on detailed rules which prescribe *how* outcomes must be achieved.

2. Rule-making: *Recommendation 15* provides that the FSRA's Board should be given explicit rule-making authority. Advocis believes that effective rule-making must allow for the drafting process to be informed not just by public input, but by input from those parties who are the subjects of those rules. In this regard, a professional association of advisors would be a valuable asset to the FSRA's rule-making process.

3. Protection of the Consumer Interest: The *Preliminary Position Paper* states that the FSRA's mandate should strike a balance "between strong and effective consumer protection and the fostering of a strong, vibrant and competitive financial services sector." Advocis believes that industry stakeholders and government should work together towards consumer protection. In the text of *Recommendation 21*, the Expert Committee is explicit that FSRA should be required to provide "a mechanism" to ensure that the perspective of consumers is considered in all of its policy-making processes and related actions. Advocis believes that the omission of a DAA for individual, consumer-facing intermediaries in the Expert Committee's *Preliminary Position Paper* is problematic. Such a DAA would in fact provide a harmonious counterpart to the proposed "enterprise-wide" Office of the Investor. It could also assist the FSRA with *Recommendations 6*

and *31*, which state that the FSRA should enhance its public engagement and communications to ensure market participants and consumers are aware of its activities.

4. Regulation of Intermediaries. *Recommendation 7* refers to a similar "regulatory framework and approach to overseeing individuals or entities selling similar products," including mutual and segregated fund dealers, insurance agents, insurance brokers, and applicable sales staff within financial institutions, such as banks." We wish to emphasize that the distribution of financial products necessarily entails the provision of financial advice – and, specifically, that in these situations that financial planning is recognized by regulators as a necessary sub-component of that advice. The FSRA's mandate should be clear on the fact that financial planning is a subset of financial advice; regulatory reform which establishes conduct and proficiency standards only for those persons who hold out as financial planners will continue to leave the majority of Ontario's consumers at unnecessary risk.

5. The Financial Services Tribunal. Advocis has several concerns with regard to the FST. First, we would urge that the FST ensure that each sector under the FST's purview have its own FST channel, so that pension experts staff FST pension panels, insurance experts sit on FST insurance panels, etc. Second, we would suggest that a DAA could assist in the province's complaint-handling process: e.g., it could function as an initial forum for the identification and possible resolution of disputes. If, after the issues have been identified, no agreement is reached between the parties, the dispute would be sent to the Ombudsman or the FST, as appropriate.

PART ONE: THE POSITIONS OF THE EXPERT COMMITTEE AND ADVOCIS ARE COMPLEMENTARY, NOT CONFLICTING

The Expert Committee's *Consultation Paper* of April 21, 2015, states that the Expert Panel is "looking for fresh ideas on how to… protect consumers of financial services… [and] maintain an appropriate balance between protecting consumers and promoting efficient markets." In response to this call to explore new avenues of reform, Advocis points to the Auditor General of Ontario's *2014 Annual Report of the Office of the Auditor General of Ontario,* which states that FSCO should delegate certain tasks to a professional organization. Advocis believes that this new organization should be a delegated administrative authority (DAA) for consumer-facing, individual financial service practitioners, such as life agents. This DAA would operate mainly by way of a principles-based approach, and supplement the Expert Committee's proposed regulatory scheme by professionalizing the advisor-consumer relationship. This professionalization would occur in the

manner set out in Advocis' proposed *Raising the Professional Bar* model, as well as in Ontario's recent Bill 157, *The Financial Advisors Act, 2014*. In effect, our proposed DAA would help Ontario better regulate complex, enterprise-level issues of market conduct and activity, while simultaneously consolidating and clarifying the regulatory oversight of financial advisors in the interest of Ontario's financial consumers.

Advocis believes that this Expert Committee's reform initiative has the potential to change the way financial advisors and planners will be regulated in Ontario; for it to succeed, it must "raise the professional bar" of financial advisors. By mandating that all financial advisors maintain membership in an accredited professional association, our DAA model would plug current regulatory gaps by bringing to bear a new focus on the principles and standards needed to govern the advisor- consumer relationship. Although the framework set out in the Preliminary Position Paper is at this point necessarily vague, we believe that it has the *potential* to be consistent with Advocis' general goals of cultivating advisor professionalism, streamlining regulation to create a more accountable and efficient financial services system, and fostering initiatives that will help consumers make informed financial decisions.

1. The relationship between the proposed Financial Services Regulatory Authority and a Delegated Administrative Authority

Advocis believes that the vision of enhanced consumer protection and more efficient market regulation which underpins the proposed regulatory framework set out by the Expert Committee in its *Preliminary Position Paper* is not at odds with but in fact is complemented by Advocis' own vision of advisor professionalization. The Expert Committee's schematic of its general regulatory framework (see Figure 3, on page 16) can easily accommodate our conception of a professional regulatory body for Ontario's financial advisors (see Figure 4, on page 17). To see how this is so, we first need to examine the essential framework set out by the Expert Committee.

The proposed mandate of the Financial Services Regulatory Authority

The Expert Committee's reform vision of a single integrated organization dictates that "significant changes in governance, structure and associated accountability mechanisms are necessary to improve mandate alignment and/or accountability."[3] If the recommendations of the Expert

[3] Ontario Ministry of Finance, *Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal, and the Deposit Insurance Corporation of Ontario: Preliminary Position Paper*,

Committee are accepted and implemented, Ontarians would see the creation of a major new provincial regulator, the Financial Services Regulatory Agency (FSRA). The FSRA would be led by an expert Board of Directors, operate at arm's length from the provincial government, and assume many of the agency functions currently under the mandates of FSCO and DICO. As well, this new regulatory authority would have reporting to it – in a manner that is interconnected with, but distinct from, the other FSRA functions – a Superintendent of Pensions, which would be responsible for overseeing the province's pensions sector. Finally, the mandate of the existing FST would be considerably amended, so that it would become separate from the proposed FSRA, as well as operationally and financially independent of it.

The need to realign financial regulatory agencies in Ontario

Advocis is pleased to note that the Expert Committee's *Preliminary Position Paper* contains a number of structural reforms to the province's retail financial services sector which support what we called for in our earlier submission of June 5, 2015. In several key areas, the paper replicates Advocis' call for a new regulatory approach to the province's financial sector – one which realigns the lines of accountability and authority regarding DICO, the FST, and the regulation of pensions. In that earlier submission we stated that "Advocis believes Ontario's financial services sector needs a new regulatory structure and improved accountability mechanisms. In fact, now is the time to reconceive of how Ontario's financial services sector is regulated, primarily by adopting a 'twin peaks' approach."[4] In large part, this is exactly what the province has done – as the *Preliminary Position Paper* states, its proposal is a "modified twin peaks"[5] approach.

Responding to challenges facing Ontarians

In Advocis' September 21, 2015 submission to the *Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives*, we expanded on a number of themes contained in our June 5 submission to this Expert Committee. We noted that Ontario is facing the confluence of a number of factors: first; the province is undergoing a demographic shift, with an unprecedented portion of the population nearing retirement age; second, the need for fiscal restraint remains

November 4, 2015, p. 4. Online at http://www.fin.gov.on.ca/en/consultations/fsco-dico/mandate-review-november15.pdf.

[4] Advocis, The Financial Advisors Association of Canada*, Submission to Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives*, September 21, 2015, p. 55. Online at http://www.fin.gov.on.ca/en/consultations/fsco-dico/mandate-review-november15.pdf.

[5] *Preliminary Position Paper*, *op. cit*., p. 8.

paramount, given that all levels of government face the financial challenge of returning to a balanced budget and that Ontario households continue to carry exceptionally high levels of personal debt; and, third, with income assistance and other social programs under continuous pressure, Ontarians will have to become more financially self-reliant in order to maintain their health and post-retirement income in the face of longevity risk.

Compounding these problems is the undeniably confusing and needlessly complex state of Ontario's current regulatory structure – which is illustrated in Figure 1, below. The duplication and complexity of the regulatory burden placed on advisors and firms which operate in both the securities and insurance sectors is perhaps matched only by the confusing lines of accountability which confront any stakeholder seeking to determine not only *how* financial products, but also financial advice, are in fact supervised and regulated, but by *whom*, and by *what standards*.

In our submission to the *Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives*, we indicated how the creation of a DAA for consumer-facing individual intermediaries could dramatically simplify the convoluted lines of reporting and accountability faced by all stakeholders. Moreover, we observed that such a reform can be accomplished with relatively little cost to the provincial government. We should note here that Advocis members, *qua* advisors, are not interested in adding additional layers of regulation or increasing their own compliance burden. Advisors know as well as any industry insider that significant percentages of the costs incurred by compliance requirements end up being borne by the consumer through higher prices, or through reduced product access, when particular products or services are priced out of existence. This is why, in terms of market conduct regulation, the regulatory scheme we propose for Ontario represents a reconfiguration almost only at the consumer level.

The underlying purpose of our proposal to both this Expert Committee and the concurrent committee considering financial advisory and planning policy alternatives is to provide comprehensive, efficacious, and cost-effective consumer protection in the financial services sector. To fulfil this purpose, our proposed DAA would cut across industry sectors to capture advisors who operate at the retail consumer level, including most prominently those in the mutual funds, securities, insurance, and pension fields.

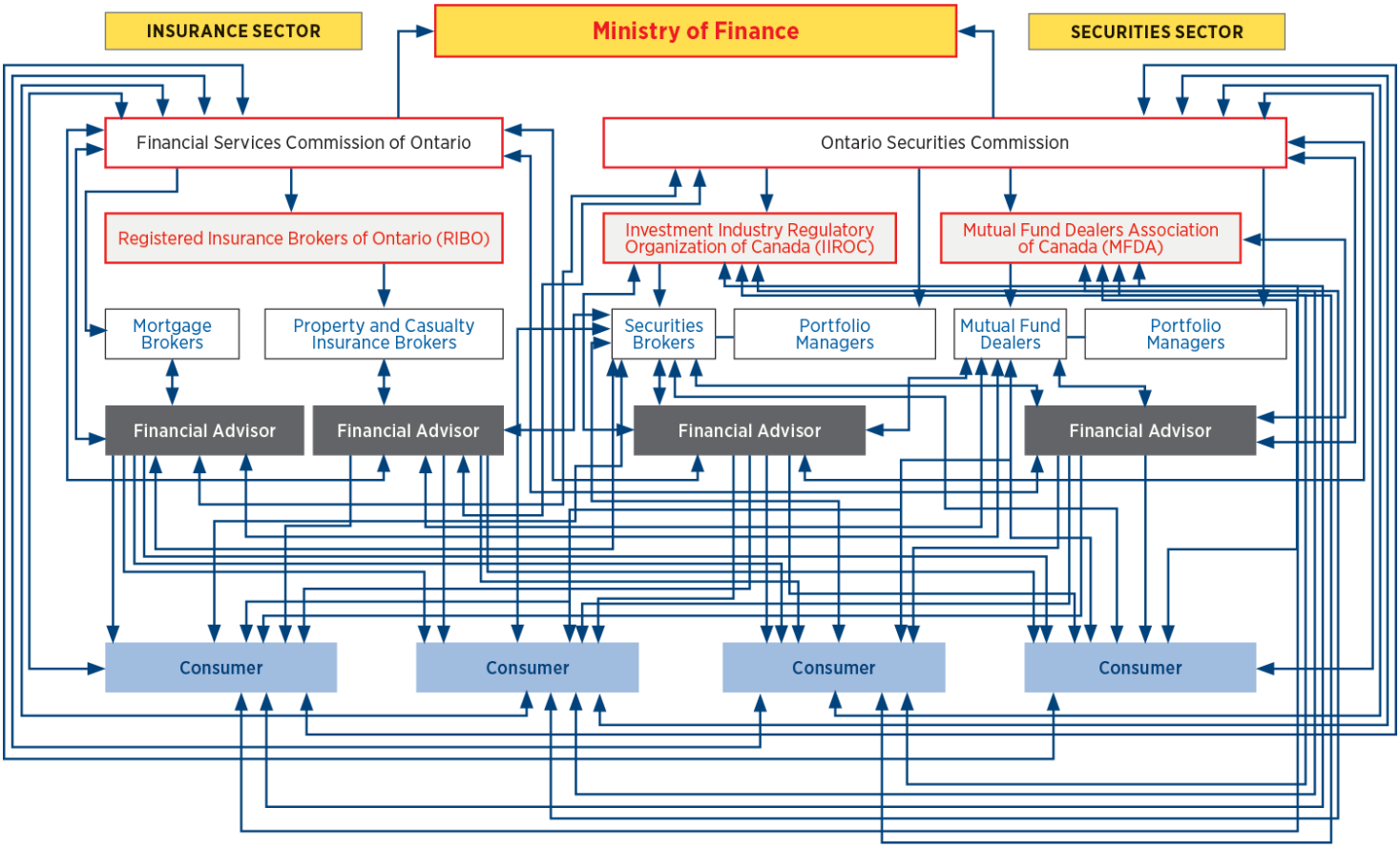


FIGURE 1: Ontario's regulatory structure has become bewilderingly complex. Clearly the needs of consumers and advisors have outgrown and outpaced the existing and largely product-based model which currently regulates the province's financial services industry. Each one of the blue lines represents a compliance requirement or other form of regulatory activity — which in the end are passed on to the consumer.

The merits of a DAA: Recognition and regulation of the relationship between the financial advisor and the Ontario consumer

In its April 21, 2015 *Consultation Paper*, this Expert Committee inquired of industry stakeholders "are there any regulated financial services entities or sectors that would be suited to a self-regulatory regime?" In its answer Advocis indicated its support for the scheme set out in the Auditor General of Ontario's *Annual Report 2014.* We remain committed to this position – namely, that FSCO should delegate certain administrative and regulatory tasks to a professional organization exclusively for financial advisors. This new organization should be a DAA for consumer-facing, individual financial service practitioners, such as life agents. It would operate

mainly by way of a principles-based approach, although the registration of individual financial advisors would be a rules-based matter for the DAA to conduct and enforce.

The DAA model is a relatively new and cost-efficient way for a group of individuals offering services to consumers to obtain professional status. As the Auditor-General noted in her *Annual Report 2014*:

> If responsibility for oversight of regulated financial sectors were to fall to associations that oversaw industries, FSCO could assume the role of overseeing those associations rather than overseeing individual companies. This would require that FSCO recommend changes to the legislation that governs these professions, but it would allow FSCO to focus its resources on more serious and strategic matters pertaining to the regulated industries...

To ensure that regulatory processes exist commensurate with the size and maturity of the industries... FSCO should explore opportunities to transfer more responsibility for protecting the public interest and enhancing public confidence to new or established self-governing industry associations, with oversight by FSCO. Areas that could be transferred include licensing and registration, qualifications and continuing education, complaint handling and disciplinary activities. In addition, associations could be responsible for establishing industry-sponsored consumer protection funds to provide more confidence in their services by the public.[6]

The Auditor General then notes that the delegation of regulatory oversight has been used by a number of the "more recognizable" service industries in Ontario, including "Accountants and auditors... Funeral directors... Insurance brokers... Investment dealers... Lawyers and paralegals... Motor vehicle salespeople... Mutual fund dealers... Real estate and business brokers... and Travel sales" as "examples of self-regulating professional organizations in Ontario."[7]

With regard to the use of a DAA model, it should be noted that the Ontario government has recently elected to delegate the administrative authority existing under the Safety and *Consumer*

[6] Auditor General of Ontario, *2014 Annual Report of the Office of the Auditor General of Ontario*, pp. 152-153.

[7] *Ibid*., p. 152.

Statutes Administrative Act, 1996 to a new DAA, which will be the driver for the province's modernization of how the funeral, transfer service, cemetery and crematorium sectors are regulated. As the government notes, "it is more effective to have a single regulator for the entire sector which will create a one-window approach for both licensees and consumers."[8] In 2016, then, a DAA known as the Bereavement Authority of Ontario will become the single regulator for the bereavement sector, handling licensing and enforcement services.

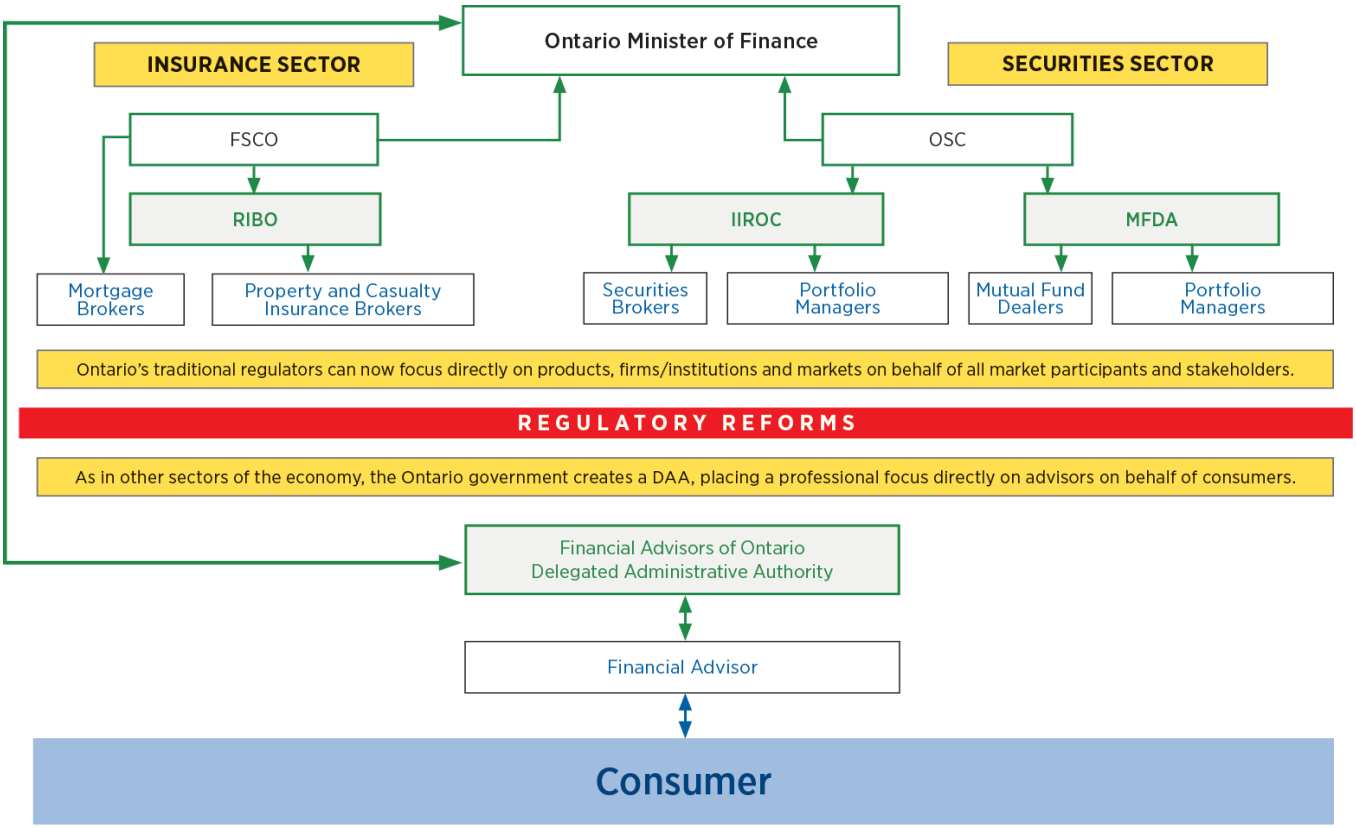


FIGURE 2: This chart shows how a DAA could provide cross-sectoral, consumer-focused regulation and sets out the parameters for a potential reform of the delivery of advice to a province's financial consumers.

[8] See Government of Ontario, "The Board of Funeral Services," June 2015, and its discussion of the work of the Ministry of Government and Consumer Services to establish the new DAA, The Bereavement Authority of Ontario. Online at http://www.funeralboard.com/Bao.

Similarly, a new DAA focused on financial advice and the relationship between the advisor and client would eliminate much of the duplication and confusion that currently exists under Ontario's product-oriented model. In contrast to the existing web of regulatory oversight (see Figure 1, on page 11) and Figure 4 (on page 17, below) illustrates the simplicity that can be achieved with a DAA which focuses on the advisor-client relationship.

Placing a unifying focus on the advisor-consumer relationship, while retaining silo-based product regulation

To ensure it can bring an effective focus to the financial advisor and consumer relationship, such a DAA would have to capture advisors operating at the retail consumer level, including most prominently those in the insurance, pension and securities sectors. To do so, it would remove direct oversight of certain elements of advisor-supplied retail consumer services from the MFDA, IIROC, OSC and FSCO. This will enable the DAA to consolidate its operations under a unified consumer protection rubric. Such consolidation would eliminate the present state of consumer and advisor confusion by introducing a coherent and immediately understandable regulatory structure to the advisor-client relationship. It must be emphasized that the silos which currently govern the insurance and securities sectors at the product level would remain intact, in order to preserve existing regulatory expertise, but they would in effect be dissolved at the level of the advisor-client relationship, to eliminate consumer confusion and regulatory arbitrage.

Advocis' approach is therefore in contrast to much of the stakeholder commentary provided last June to the Expert Committee, which in the main suggested that the regulatory focus of the Expert Committee should be on the *products* being sold to Ontarians, not on the *advice* being provided to them. Given our position on a DAA, Advocis is pleased to note that the *Preliminary Position Paper* states that the FSRA "should be given authority over, and responsibility for, the oversight of any self-regulatory body operating within the financial services sector in Ontario (not otherwise overseen by another statutory body). Moreover, the paper states, the FSRA's mandate should therefore "include the obligation to work and cooperate with other regulators (including self-regulatory organizations) that oversee the providers, sellers and intermediaries of financial products and coordinate regulatory actions to avoid regulatory overlap and arbitrage and to ensure that consumers can be confident in their dealings with these entities or individuals."[9]

[9] *Ibid.,* p. 10.

Figure 3 (page 16, below), sets out the regulatory realignment proposed by the Expert Committee's *Preliminary Position Paper*; Figure 4 (page 17, below), shows how a DAA of the kind proposed by Advocis can be inserted into that framework without compromising it – in fact, a DAA of the kind which Advocis is proposing will only add flexibility and resiliency to the Expert Committee's proposed framework. A comparison between Figures 4 and 1 shows that our reform proposal would simplify the roles and responsibilities of anyone who in name or in practice holds out as a financial advisor to Ontario's financial consumers and retail investors. As well, Figure 4 shows how a DAA for Ontario's financial advisors would interact with other aspects of Ontario's financial markets and with the Expert Committee's proposed framework.

Thus our proposed DAA would supplement (but in no way supplant) today's rule-based, transaction-driven regulatory model – which focuses almost exclusively on financial products – with a new, largely principles-based focus on the consumer protection concerns of Ontarians. This new DAA would be flexible enough to provide for timely and pragmatic responses to emerging regulatory concerns. It would capture the entire continuum of the advisor-client relationship: i.e., both one-time transactions (e.g., the sale of a segregated fund) and ongoing, long-term advisor-client relationships (e.g., the decades-long relationship between an advisor and a client, aspects of which can range from mere order-taking to full discretionary authority).

The proposed DAA-based regulatory approach will not disrupt any existing product-related regulation. In addition, if the provincial government adopts the Expert Committee's proposed framework, then we would note that a review of the existing SROs for regulatory and cost efficiencies would be more easily managed in this consumer-focused model. It is critical to recognize that a single professional body brings with it clearly demarcated regulatory accountabilities, which in turn will yield efficiency gains and produce a cohesive professional *ethos*, one to be practiced by advisors and demanded by consumers. Advocis' DAA model removes confusion, costs, duplication and overlap; quickly address sector-specific problems; and simplify what is currently an unreasonable and confusing system for consumers. The expected result will be enhanced levels of consumer protection and satisfaction.

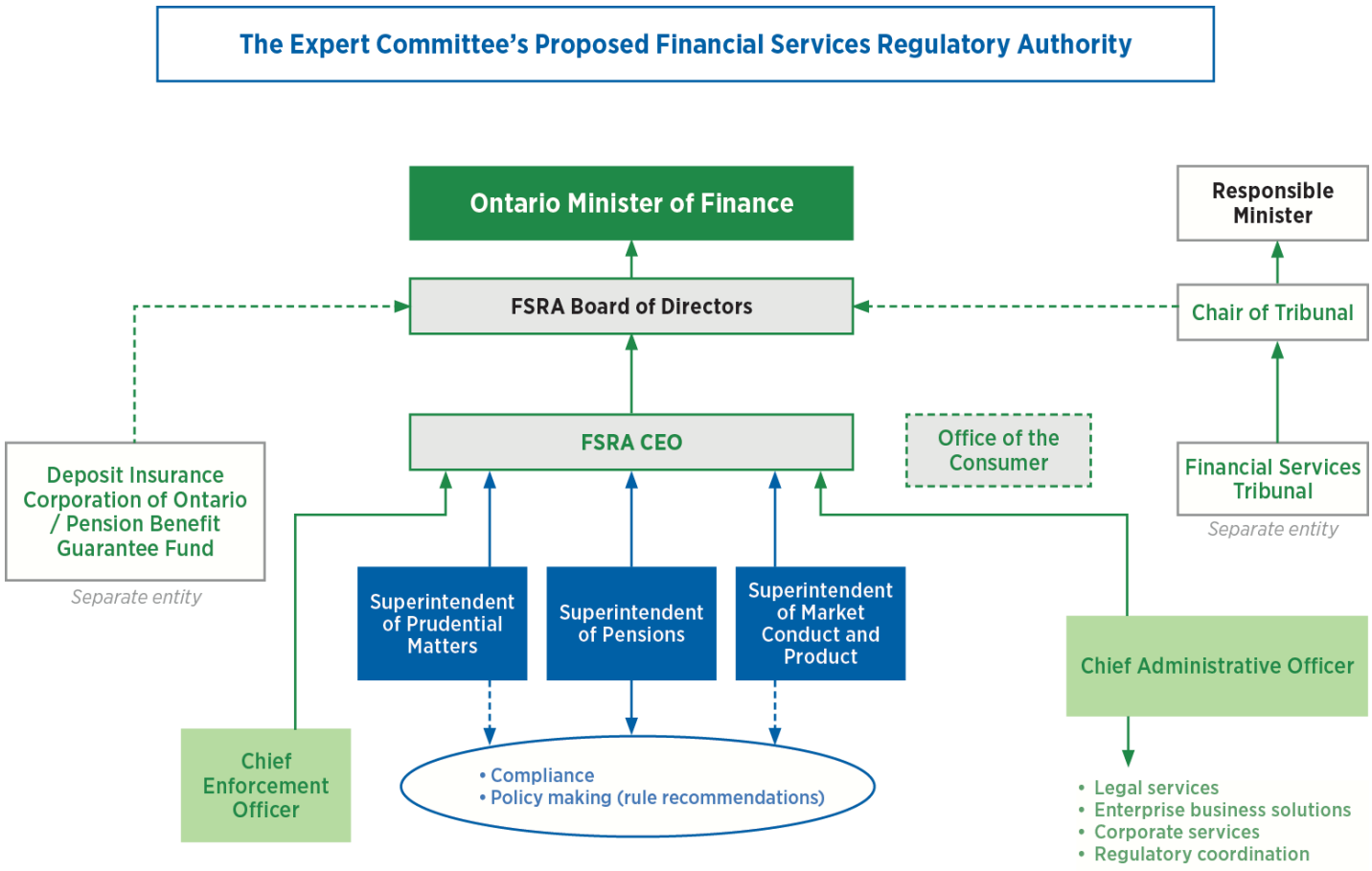


FIGURE 3: This chart sets out the realignment proposed by the Expert Committee in its *Preliminary Position Paper*.

Finally, the proposed DAA can be structured to develop and evolve dynamically: at the outset, it can be required to report to the FSRA and operate under the aegis of its management and board of directors, or, in the alternative, to the Superintendent of Market Conduct. If, after a prescribed period of time (e.g., 24 months), the DAA has fulfilled key performance benchmarks intended to measure its efficacy with regard to the functions of licencing, registration, etc., then the oversight of the DAA could be transferred to the Ontario Minister of Finance, in effect making the DAA into an independent professional body.

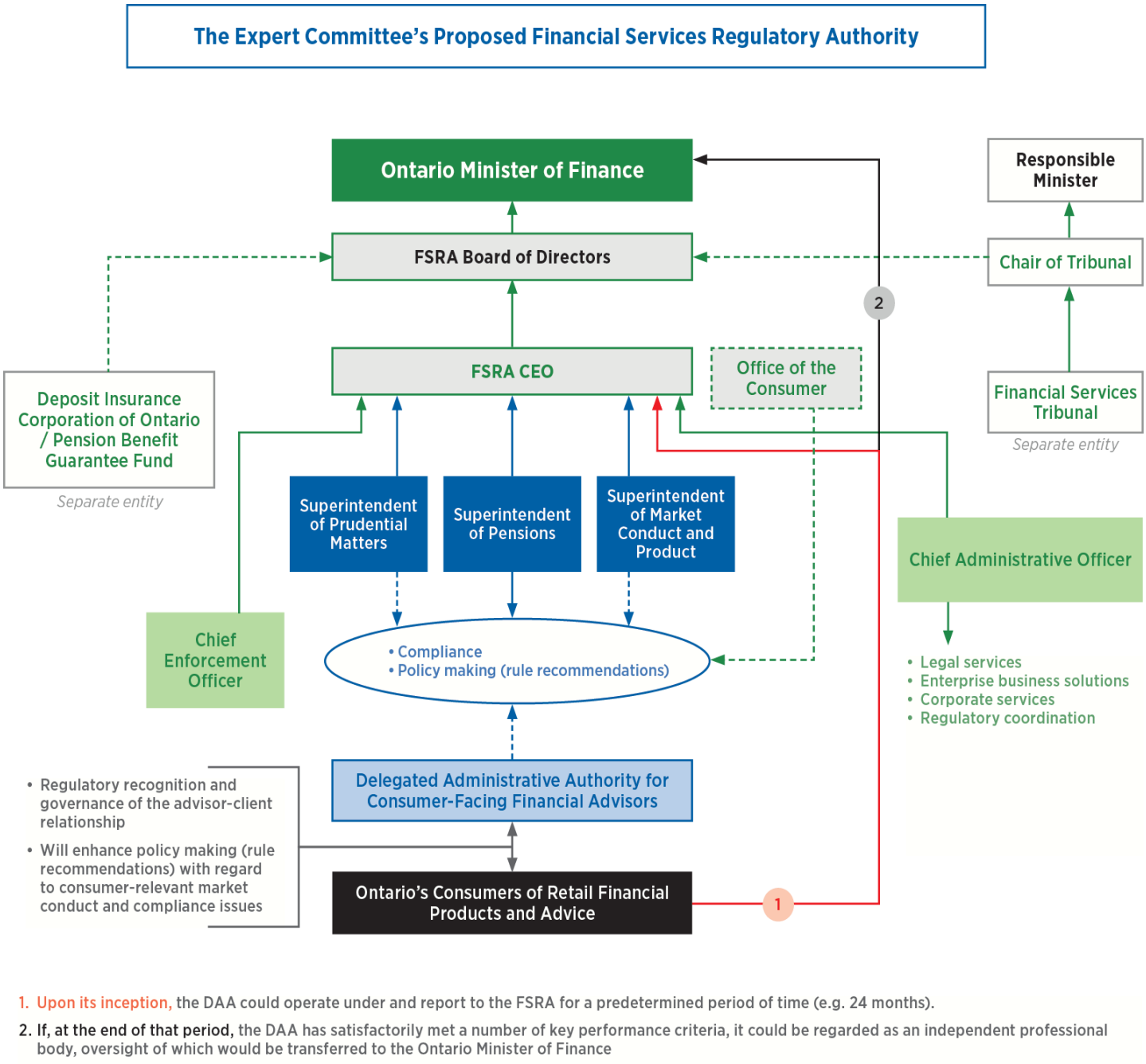


FIGURE 4: This chart shows how a DAA could fit within the proposed framework set out in the Expert Committee's *Preliminary Position Paper*.

2. The FSRA and the future of FSCO-style regulation

The other set of general comments Advocis wishes to offer here relate to the proposed FSRA and the future of FSCO-style insurance regulation in Ontario. It appears that the FSRA would absorb

most or all of FSCO and its responsibilities. It is not clear what would be the relationship – if any – between the FRSA and the Ontario Securities Commission (OSC). Given the paucity of detail currently available, Advocis has a number of concerns, including the possible demise of effective, efficient insurance regulation in Ontario. The regulatory expertise developed by FSCO through decades of working with industry stakeholders would very likely be lost in the proposed FSRA, and FSCO's principles-based approach to insurance regulation would be replaced by a securities-style, rules-based approach. This would be unfortunate, both for advisors and consumers, as such an approach is not needed or even appropriate for the sales processes of the vast range of products and services offered by licensed life agents. The immediate consequence of such a dramatic shift in regulatory approach would be to drive up the costs of even basic life products –which is not an optimal result, given that the life industry is already facing thinning profit margins on life products and will have to confront ongoing interest rate risks for the foreseeable future.

We also have concerns about the FSRA becoming a monolithic, "too-big-to-fail" organization – that is, it becoming a complex and highly routinized bureaucracy so entrenched and inflexible that regardless of the intentions of its senior staff, it becomes intransigent in the event that the need for timely structural or mandate-based changes should arise. While FSCO is a body which enforces existing legislation, the FSRA in its totality could all too easily function as a hybrid that would have decision-making, rule-making and adjudicative powers, similar to the current OSC. The proposed purview of the FSRA would subject various subsectors of the province's financial markets to a "super-regulator" which would regulate life agents and insurance brokers, mortgage brokers, credit unions, and pension funds. This would mean that the future financial well-being of nearly every working- and middle-class Ontarian would be beholden to this super-regulator to a greater or lesser degree, provided he or she has a mortgage, and/or owns a life insurance policy, etc. In order to limit the risk of disruption from the advent of such a regulatory force to firms, financial advisors and their clients, the establishment of a countervailing body such as a DAA which can represent the interests of the advisor-client relationship strikes us as a practical and even necessary measure.

PART TWO: THE EXPERT COMMITTEE'S 37 RECOMMENDATIONS

To support the proposed realignment of Ontario's financial sector, the Expert Committee has made 37 specific recommendations. The most significant of these recommendations, for the purposes of Advocis members and their clients, are examined below.

1. Policy Formation

Recommendation 28 states that the "FSRA should be required by statute to take a risk-based and outcomes-based approach to regulation, through which the policy objectives and likely outcomes are considered and explicitly articulated."[10] In order to better assess the merits of the proposed FSRA, Advocis would like to see the terms "risk-based regulation" and "outcomes-based regulation" defined, along with a contextual explanation of their role in the FSRA's regulatory philosophy, particularly with regard to market conduct concerns.

The meaning of risk-based regulation

In general, Advocis supports risk-based approaches to regulation, as risk-based regulation typically has advantages for regulators, firms and consumers. For regulators, risk-based approaches help them better focus their efforts and direct their limited resources towards issues which can produce a significant improvement in consumer protection; for firms, the expensive practice of compliance monitoring can be cost-contained (at least to a degree) by directing firm resources to discrete and readily identifiable areas of regulatory concern; for consumers, risk-based approaches increase, often significantly, the likelihood that effective preventative measures will be introduced when and where they are most required.[11]

However, the term "risk-based regulation" embraces a very broad range of approaches. In some cases it represents an entire framework of governance – as is the case, for example, with the Office of the Superintendent of Financial Institutions (OFSI) – while in other cases it refers to an *ad hoc* approach based on the pragmatic adoption of the risk-based tools that the particular agency has at its disposal. With regard to market conduct concerns, Advocis therefore wonders to what extent the FSRA would represent a departure from a flexible and qualitatively-based process of standard-setting to a more formal, calculative "'cost-benefit analysis" culture. While we firmly believe that cost-benefit analyses are a necessary regulatory tool, particularly with regard to the concerns of prudential regulation, we also believe that at the level of market conduct, an integrated and more holistic approach is necessary to deal with issues involving intermediaries and consumers. With

[10] *Preliminary Position Paper*, *op. cit*., p. 10.

[11] See in general Diana Farrell, Biniam Gebre, Claudia Hudspeth, and Andrew Sellgren, *Risk-based resource allocation: Focusing regulatory and Enforcement Efforts Where They are Needed the Most*. McKinsey & Company, February 2013; Dr. Julia Black, *The Development of Risk Based Regulation in Financial Services: Canada, the UK and Australia*. London School of Economics and Political Science, ESRC Centre for the Analysis of Risk and Regulation, September 2004.

regard to the advisor-client relationship, then, we hope and expect that the focus will of necessity be on the market conduct of the advisor and his or her firm.

Advocis would like to know if the FSRA will seek to retain the approach to risk-based regulation which FSCO has developed and publicly described: see, for example, the discussion of risk-based regulation in FSCO's 2015 document entitled *Regulatory Framework.*[12] We would further note that the Canadian Council of Insurance Regulators (CCIR) has defined "risk-based Market Conduct Regulation" as "directing regulatory efforts to the most significant issues that either have the greatest potential for consumer harm or that could weaken public confidence if left unchecked. In a risk-based approach, regulators prioritize issues based on their potential impact (risk) to the achievement of desired regulatory outcomes."[13]

A sector-specific example of risk-based regulation was recently set out by FSCO in the form of a comprehensive framework for Ontario pension plans in its *Risk-Based Regulation Framework: Consultation Document*.[14] Another question, therefore, is whether the model of risk-based regulation to be adopted by the proposed FSRA will represent a continuation of the FSCO model. Given that many financial risks are interrelated to one another and have broader potential consequences for the economic and social environments in which Ontarians live, the abandonment of FSCO's approach could have serious and negative consequences.

Outcomes-based regulation and the future of principles-based regulation

Similarly, we would ask the Expert Committee to provide an operational definition of the term "outcomes-based regulation." We note that the term "principles-based regulation" (PBR) is absent from the Expert Committee's *Preliminary Position Paper* and query whether that omission should be taken to mean that the proposed FSRA would abandon in part or in whole FSCO's long-held commitment to PBR.

[12] Financial Services Commission of Ontario, *Regulatory Framework*, May 2015, pp. 5-7. Online at http://www.fsco.gov.on.ca/en/about/annual_reports/Documents/2014-Reg-Framework.pdf.

[13] Canadian Council of Insurance Regulators, *An Approach to Risk-Based Market Conduct Regulation*, October 2008, p. 5. Online at http://www.ccir-ccrra.org/en/init/rbmc/Approach_to_RbMC_FinalDoc_Oct10.pdf.

[14] See Financial Services Commission of Ontario, Risk-*Based Regulation Framework: Consultation Document*, March 2011. Online at https://www.fsco.gov.on.ca/en/pensions/Documents/RBRCons Paper.pdf.

PBR is sometimes described as similar to or a form of outcomes-based regulation, due to the fact that certain known outcomes are prescribed in regulation while leaving a certain amount of discretion and responsibility to the regulated firms to take the actions needed to ensure the attainment of those outcomes.[15] As Ontario Securities Commissioner Mary Condon has noted, PBR is generally taken to have the following components:

- promulgation of high-level standards that are drafted at a broad level of generality;
- a focus on an outcomes-based approach, which is concerned more with whether a regulatory participant achieves a certain outcome, such as "treating customers fairly" than whether it abides by universally-applied procedural rules drafted by a regulator;
- commitment to enhanced stakeholder participation in the design of principles;
- increased responsibility of regulated entities' senior management for the implementation of principles within firms; and
- reliance on constant improvement of industry best practices and guidance with respect to best practices rather than prescriptive rule-making.[16]

Advocis has been a long-time supporter of PBR and therefore would ask the Expert Committee to indicate what role PBR would play in the formulation and enforcement of financial regulation under the proposed FSRA.

Advocis' recommendation is for principles-based, outcomes-focused regulation

Advocis believes that the principles-based regulatory approach of FSCO should be continued with regard to the activities of life-licensed financial advisors, and that wherever possible, rules should be drafted with an eye to flexibly guiding intermediaries towards preferred outcomes. We advocate for a regulatory approach to supervision of individual consumer-facing intermediaries which relies on principles and outcome-focused rules, rather than on detailed rules which prescribe *how* outcomes must be achieved.

The result of adopting (where appropriate) a principles-based, outcomes-focused regulation, will be that individual advisors – and the firms which employ them – have increased flexibility in how

[15] Mads Andenas and Iris H-Y Chiu, *The Foundations and Future of Financial Regulation: Governance for Responsibility*, Routledge (2014), p. 100.

[16] Mary Condon, "Canadian Securities Regulation and the Global Financial Crisis" [The Walter S. Owen Lecture]", *UBC Law Review*. Volume, 42, Number 2 (2010), p. 473-491, at pp. 479 – 481.

they deliver the outcomes that the regulator requires. As well, many advisors and their firms may find a closer fit between meeting their business objectives and meeting regulatory requirements if those requirements were promulgated with their input. In such a manner, responsibility for key regulatory policies moves to those persons who must fulfill those policies, which will lead to a better mobilization of firms' compliance, risk management and internal audit functions.

Finally, Ontario's consumers can benefit from this principles/outcomes approach to regulation through the incremental but steady fostering of a more innovative and competitive financial services industry in the province. Longer term, under such an approach, Ontario's consumers should be able to play a valuable role in driving the industry forward: as they become progressively more financially literate, the regulatory principles and consumer products will have to evolve to keep pace with their enhanced consumer capacity. Furthering levels of consumer financial literacy is of course an Advocis commitment and could be made a necessary precondition for any advisor-based DAA in Ontario.

2. Rule-making under the proposed Financial Services Regulatory Authority

Recommendation 15 provides that the FSRA's Board should be given explicit rule-making authority, the scope of which is clearly delineated in the enabling statute. Section 15.a states that "[r]ules should be drafted with significant public input and dialogue, and be subject to a rule making process set out in the statute."[17]

Advocis believes that effective rule-making must allow for the drafting process to be informed not only by public input, but also with input from the parties who are to be the subjects of those rules. Obviously, canvassing a large and disparate group of industry stakeholders about the merits of a future piece of regulation entails its own set of problems, which is why Advocis believes that a professional association of advisors would be a valuable asset to the FSRA's rule-making process.

More specifically, a DAA would enable the FSRA to query by way of interviews, surveys, etc., a large body of licensed advisors who could provide feedback on the *least intrusive means* by which a proposed rule could be drafted, and how a proposed rule would fit or conflict with established industry best practices and client expectations. Indeed, Advocis has historically assisted FSCO in this manner; most recently, from 2013 to 2015, FSCO engaged with Advocis and other industry

[17] *Preliminary Position Paper*, *op. cit*., p. 11.

stakeholders in the conduct of its comprehensive Life Insurance Product Suitability Review (Point-of-Sale) review.[18]

3. The Protection of the Consumer Interest

The *Preliminary Position Paper* states that the FSRA's mandate should strike a balance "between strong and effective consumer protection and the fostering of a strong, vibrant and competitive financial services sector." It further states that this mandate should be informed by the 10 principles in the OECD's *G20 High-Level Principles on Financial Consumer Protection*. Advocis welcomes the realignment of regulatory focus onto the needs of Ontario's consumers. The *Preliminary Position Paper* has a number of consumer protection measures which reflect a number of Advocis' proposals and promise to address a number of concerns we have voiced of late. Among the proposed measures are requirements to ensure:

(1) enhanced transparency within the regulated sectors, including the disclosure of all costs of products and services, as a means of consumer protection;
(2) the establishment and oversight of a compensation fund for consumers who become victims of fraud due to the activities of a licensed intermediary; and
(3) the creation of a mechanism, including an Office of the Investor, "to ensure that the perspective of consumers is considered in all of its policy-making and actions."

With regard to (3), Advocis of course has long championed the need for a new focus on the consumer perspective. But the way the FSRA proposes to ensure that the consumer point of view is factored into policy development is incomplete.

Increasing transparency under the FSRA will also require regulatory recognition of the advisor-client relationship

With regard to *Recommendation 6*, which calls for the FRSA's mandate to "include a commitment to encourage innovation and transparency within the regulated sectors," Advocis would note that the role of disclosure as a technique in retail market regulation has its limits, which are probably now being approached by the nature of the registrant obligations set to take effect on June 15, 2016 as part of the latest and last round of the Client Relationship Model or CRM2 reforms. There is a growing body of empirical evidence suggesting that, after a certain stage of market-oriented

[18] See Financial Services Commission of Ontario, Life Insurance Product Suitability Review (Point-of-Sale). Online at www.fsco.gov.on.ca/en/insurance/Pages/eblast-point-of-sale-sept-2014.aspx.

disclosure, the decision-making process of the retail consumer or investor is no longer enhanced and may in some cases be hampered.

Of course, simplifying and standardising financial product information can significantly improve the effectiveness of investment decisions. In fact, one EU study found that "standardising and *reducing* the amount of information provided helped subjects identify the optimal choice between similar investments."[19] (emphasis added). The study also concluded that "Policy makers must also be careful when introducing new disclosure requirements to not "simply elicit a 'knee-jerk' loss of trust in advice that may not be in consumers' best interest, especially given their limited capacity to make good decisions without the help of an advisor."[20]

Again, this phenomenon points to the value of professional financial advice and the pressing need for a regulatory recognition of the advisor-client relationship. Too much information can overwhelm, and information without insight can prove dangerous to the consumer.

Enforcement and Fraud Compensation by the Financial Services Regulatory Authority

Recommendation 4b calls for the FSRA's mandate to require it to "utilize its statutory powers to adequately, firmly and consistently enforce provisions and, in particular, prohibitions against fraudulent activities or behaviours that harm consumers." [21] *Recommendation 23* and *Recommendation 29* then provide a framework for this anti-fraud strategy:

23. Consideration should be given to an expanded mandate for FSRA to include the establishment and oversight of a fraud compensation fund.

    a. The fund could indemnify those individuals who become victims of fraud due to the activities of a licensed individual or entity. This would place an onus on consumers to determine whether the intermediary is licensed.

    b. The fund could be a payer of last resort only after determining that either no applicable errors-and-omissions insurance or fidelity bond coverage existed, that the coverage would be insufficient, or that the coverage would exclude all but a narrowly defined type of fraud.

[19] Nick Chater, Steffen Huck and Roman Inderst, Warwick Business School and Online Interactive Research Ltd., *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective*, November 2010, p. 9.

[20] *Ibid.*, p. 11.

[21] *Preliminary Position Paper*, *op. cit*., p. 17.

c. The fund could be paid for by premiums applied to licensing fees, by penalties levied by FSRA for non-compliance, and by court-awarded damages that FSRA could seek on behalf of the victims of fraud.

d. The fund should exist outside of FSRA, with a requirement that it be monitored by and held accountable to FSRA…

29. FSRA should be given authority through appropriate legislation to levy Administrative Monetary Penalties in the pension sector, and in any other sector it regulates, to provide consistent enforcement tools within its jurisdiction.[22]

At present, there remains too much fraudulent activity in Ontario's financial services industry. Most of it is, in our view, avoidable. Somewhat surprisingly, the century-old model of the Ponzi scheme continues to account for a significant portion of overall fraud. Such schemes are almost always the work of non-registered advisory firms and individuals. The FSRA could make the activity of providing financial advice to retail-level consumers illegal if the individual is not a member of a DAA. Under this approach, the FSRA or the police service in the jurisdiction at issue would not have to wait for a consumer complaint in order to act, but could be statutorily empowered to respond to the action of giving unlicensed advice, well before the entire fraudulent scheme is allowed to advance beyond any reasonable prospect of preserving and returning investor capital.

Industry can and must complement the government in providing mechanisms for consumer protection

In *Recommendation 21*, the Expert Committee is explicit that FSRA should be required to provide "a mechanism" to ensure that the perspective of consumers is considered in all of its policy-making and actions. This mechanism "should include the creation of a separate 'Office of the Consumer' to perform this and related functions. It should not be organized as a silo, but rather with enterprise-wide responsibilities to ensure that consumer perspectives are considered in all regulatory endeavours pursued."[23]

But there are problems inherent in the establishment of a notionally independent consumer advocate, including the "revolving door" hazard – a phenomenon clearly demonstrated in recent years in the United States with ratings agencies – in which the staff of the supposedly independent

[22] *Ibid*., pp. 13-14.

[23] *Ibid.,* p. 13.

agency is routinely recruited by the firms whose products they are required to evaluate in a neutral, conflict-free manner. The other problem is an inverse of the first: the advocacy office can all too easily become a "mouthpiece" for the industry regulator, parroting the virtues of the government's actions, while the needs of the average consumer are left without a voice. One has only to look at the dire "advice gap" which has arisen in the United Kingdom (where thousands of citizens can no longer afford basic financial advice due to the ban on embedded third-party compensation) and the highly ineffective response of the "consumer-focused" Money Advice Service.

This very legitimate concern about the need for informed consumer protection which is independent from the government and its regulator leads to the consideration of what Advocis believes is absent from the Expert Committee's *Preliminary Position Paper* – a DAA for individual, consumer-facing intermediaries. Such a DAA would in fact provide a harmonious counterpart to the proposed "enterprise-wide" Office of the Investor. Indeed, such a DAA could help the Office of the Investor "to ensure that consumer perspectives are considered in all regulatory endeavours pursued."

Such a DAA could also assist the FSRA with *Recommendations 6* and *31*, which state that the FSRA should enhance its public engagement and communications to ensure market participants and consumers are aware of its activities. For example, to ensure transparency, a DAA could be mandated to implement an email service that would send subscribers daily notices of publications, enforcement actions and consumer education documents, and it could also be tasked of keeping the FSRA informed with regard to those issues that could either compromise consumer protection, or lead to improvements that would benefit consumers.

4. The Regulation of Intermediaries

Recommendation 7 of the Expert Committee provides the tools needed for a co-ordinated and holistic approach to the regulation of financial advisors. It states that:

> 7. FSRA's mandate should include the obligation to work and cooperate with other regulators (including self-regulatory organizations) that oversee the providers, sellers and intermediaries of financial products and coordinate regulatory actions to avoid regulatory overlap and arbitrage and to ensure that consumers can be confident in their dealings with these entities or individuals. This would include:

a. A similar and familiar regulatory framework and approach to overseeing individuals or entities selling similar products within its jurisdictional oversight (e.g., mutual and segregated fund dealers, insurance agents, insurance brokers, and applicable sales staff within financial institutions, such as banks).

b. Common and consistently applied standards for all relevant intermediaries, including agents and brokers selling like products.

c. Enhanced sharing of pertinent information and communication among regulators to ensure disciplinary and enforcement consistency so that regulatory activity by one regulator is appropriately applied by another.

d. Those powers and tools necessary to ensure the application of what is set out above.[24]

Advocis can support several aspects of FSRA's proposed mandate, since they reflect a number of our concerns about how to better oversee "the providers, sellers and intermediaries of financial products" in Ontario's retail financial sector. These include:

- the coordination of regulatory actions to avoid regulatory overlap and arbitrage, and enhanced inter-regulator communication to ensure consistency in disciplinary and enforcement action ;
- the establishment of a regulatory " framework and approach" for overseeing sales-related activity by advisors and their firms (these parties are identified by the Expert Committee as being "mutual and segregated fund dealers, insurance agents, insurance brokers, and applicable sales staff within financial institutions, such as banks"; and
- the introduction of common, consistently applied standards for all advisors selling similar products.

The selling process: the distribution of products necessarily entails the provision of advice.

Recommendation 7 refers to a similar "regulatory framework and approach to overseeing individuals or entities selling similar products," including "mutual and segregated fund dealers,

[24] *Ibid*., p. 10.

insurance agents, insurance brokers, and applicable sales staff within financial institutions, such as banks."[25] We wish to emphasize that the distribution of financial products necessarily entails the provision of financial advice – and, specifically, that in these situations that financial planning is recognized by regulators as a necessary component of that advice. This is true on both the securities and insurance sectors.

(i). Securities

Financial planning is a necessary component of providing financial advice or making a recommendation on a security – regardless of whether it is a bread-and-butter money market fund or a sophisticated exempt market security. For example, the CSA's National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), requires a registrant to take reasonable steps to ensure that, before it makes a recommendation to, or accepts an instruction from, a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.[26] In addition, the CSA's related *Companion Policy 31-103*, in section 3.4 [Proficiency – initial and ongoing], states that an individual "must not perform an activity that requires registration unless the individual has the education, training and experience... including understanding the structure, features and risks of each security the individual recommends."[27] Similarly, MFDA Policy No. 2 *Minimum Standards for Account Supervision*, MFDA Rule 2.2.4 *Updating Client Information*, MFDA Member Regulation Notices *Know-Your-Product* (MSN-0048) and *Suitability* (MSN-0069) all provide further guidance on these ongoing obligations for securities registrants.

IIROC, like the MFDA, requires that its members engage in the same level of basic planning activity in the sale of securities to clients. For example, IIROC Rule 1300 *Supervision of Account*s, IIROC Rule 2500 *Minimum Standards for Retail Account Supervision*, and IIROC *Guidance Note 12-0109 Know Your Client and Suitability*, all require that the dealer member or its registered representative maintain compliance with IIROC's various KYC obligations and investment suitability requirements. For example, IIROC *Guidance Note 12-0109* requires that KYC information be collected and

[25] *Ibid*.

[26] National Instrument 31-103 - *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, p. 44. Online at https://www.osc.gov.on.ca/documents/en/Securities-Category3/ni_20150111_31-103_unofficial-consolidated.pdf.

[27] Canadian Securities Administrators, Companion Policy 31-103 CP - *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, p. 150. Online at https://www.osc.gov.on.ca/documents/en/Securities-Category3/ni_20150111_31-103_unofficial-consolidated.pdf.

assessed and product suitability obligations be fulfilled. IIROC Rule 1300 requires that the dealer member, when accepting a client order, when providing a recommendation to a client, or when certain triggering events occur, use due diligence to ensure that the order, recommendation or account position is suitable for the client "based on factors including the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts' current investment portfolio composition and risk level."[28]

(ii). Insurance

Financial planning is also recognized by regulators as a necessary component of insurance advice. Indeed, FSCO in recent years placed a special emphasis on providing regulatory oversight and guidance for the province's insurance-licensed financial advisors (and their clients) with regard to the suitability of product recommendations, the disclosure of conflicts of interest, and the ability of consumers to make informed decisions. From 2013 to 2015, FSCO engaged with industry stakeholders in the conduct of its comprehensive *Life Insurance Product Suitability Review (Point-of-Sale)*. This was a comprehensive review of how effectively advisors are ensuring product suitability for clients when engaged in the process of recommending life insurance products. This stakeholder review was undertaken with a special focus on "practices in the field," on determining the level of product knowledge possessed by the average consumer, and on how best to address any information deficits on either side of the advisor-client relationship, including through enhanced product disclosure and by ensuring professional-level advice is consistently provided through the use of best practices to ensure that advisors ask clients the correct questions to gather the necessary data for a proper needs analysis so the insurance advice will meet the client's financial needs and objectives.

In sum, FSCO was acting to ensure that advisors were meeting *de minimus* standard of proficiency when providing planning advice prior to a product sale. In its *Life Insurance Product Suitability Report* of September 2014, FSCO set out the findings of the review and affirmed that its recommended "best practices are largely being followed i.e. the actual practices do reflect the needs-based sales practices described in *The Approach: Servicing the Client Through Needs-Based Sales Practices*.[29]

[28] See Investment Industry Regulatory Organization of Canada, IIROC Rule 1300 Supervision of Accounts, 1300.1(p) to (s). Online at www.iiroc.ca/Rulebook/MemberRules/Rule01300_en.pdf.

[29] See Financial Services Commission of Ontario, *Life Insurance Product Suitability Review (Point-of-Sale)*. Online at www.fsco.gov.on.ca/en/insurance/Pages/eblast-point-of-sale-sept-2014.aspx.

Financial planning is also inherent to the process of providing advice on life insurance products and on insurance products which have an investment component, such as individual variable insurance contracts (IVICs), more commonly known as segregated funds. For life agents, the needs-based sales practice product suitability requirements are set out in the industry guideline entitled *The Approach: Serving the Client through Needs-Based Sales Practices* (January 2015) from the CLHIA. Segregated funds have a wealth of guidance documentation which is explicit about the financial planning aspect of providing advice or making a recommendation about a segregated fund. Ontario Regulation *132/97 (Variable Insurance Contracts)*, issued pursuant to the province's *Insurance Act*, incorporates by reference CLHIA Guideline G2 – *Individual Variable Insurance Contracts Relating to Segregated Funds*. Among other things, CLHIA G2 Guideline establishes industry standards for advisors to follow with regard to disclosure in point-of-sale IVIC documents and contracts.

In addition, the CLHIA Reference Document of February 2013 entitled *IVIC Suitability Needs-Based Sales Practices* sets out the three steps for advisors to follow: fact-finding, needs assessment and recommendations and advice. The document is explicit about the nature of the practices the advisor is expected to carry out:

> The task of the advisor is to identify the financial needs of the consumer to ensure the IVIC product is suitable for them in light of their particular circumstances and then assist the consumer in understanding how the product meets his or her financial needs.[30]

The CLHIA document further notes that:

> Each of these steps requires skill and judgment on the part of the advisor. As noted in *The Approach*, the specific questions the advisors should ask will vary depending on the circumstances of the individual client and the complexity of the products being considered... the advisor must decide on an appropriate level of inquiry and choose an approach that will effectively elicit the information required to identify the client's needs. The process of assessing needs... requires that the advisor make judgements about the priorities of the client and differentiate between wants and needs.[31]

[30] Canadian Life and Health Insurance Association, *Reference Document: IVIC Suitability Needs-Based Sales Practices* (February 2013), p. 2.

[31] *Ibid*., p. 2.

The CLHIA is explicit about the planning entailed in providing advice to a client with regard to product suitability; the advisor is expected to ask "More detailed questions following the preliminary assessment focus on acquiring a better understanding of the client's needs *to help determine whether or not an IVIC can form part of a suitable product allocation*"[32] (emphasis added). As for CLHIA *Guideline G2: Individual Variable Insurance Contracts Relating to Segregated Funds* (January 2011), it requires that the segregated fund's "Fund Facts should, in section 7, state "in plain language for the average retail consumer" who the fund is for:

> Item 7 – Who is this fund for?
> Provide details regarding the type of investor the segregated fund would be suitable for stating the advantages and any necessary cautions or warnings. Suitability should be tied to the fundamental investment objective of the fund and risk category assigned in Item 5 above.[33]

Finally, the CLHIA's consumer brochure, *Key Facts About Segregated Funds Contracts*, sets out quite clearly the nature of this financial planning the consumer should expect from his or her advisor:

> Your advisor will provide you with written disclosure about the companies he/she represents, any conflicts of interest and how he/she is paid. The insurance advisor's professional qualifications permit him/her to help you analyze your retirement income planning, estate planning and insurance needs, make recommendations that meet those needs and provide ongoing services, such as beneficiary changes, reviewing and updating your investment strategy and rebalancing your portfolio.[34]

With regard to the provincial insurance councils, a cursory review of the Canadian Insurance Regulators Disciplinary Actions database indicates that insurance councils also recognize the central

[32] *Ibid.*, p. 4.

[33] Canadian Life and Health Insurance Association, Guideline G2: *Individual Variable Insurance Contracts Relating to Segregated Funds* (January 2011), p. 77.

[34] Canadian Life and Health Insurance Association, *Key Facts About Segregated Funds Contracts*, p. 7.

role held by financial planning in the advice which advisors provide to their clients[35]. It is telling that in several recent cases from the Insurance Council of British Columbia, the disciplined advisors were ordered to take CFP® and/or CLU® courses.

For example, in the May 1, 2014 decision of *In the Matter of the Financial Institutions Act (R.S.B.C. 1996, c. 141) (The "Act") and The Insurance Council of British Columbia ("Council") and Grant Sheldon Persal*[36] (May 1, 2014), the Council found that the life agent, among other issues, successfully advised his clients to purchase an insurance product that they did not fully understand. In reaching its decision, the Council summarized the investigation and review done by its Review Committee, which examined a number of precedents. For example, the Council noted that:

> In *J. Duke*, the licensee made inappropriate recommendations to a client regarding investments in exempt market securities in light of the client's age, risk tolerance, and financial profile. The licensee was an experienced insurance agent who knew, or ought to have known, the risk posed by the investment was too high for his client and he should not have recommended the investments. The licensee's licence was suspended for 12 months, [and] he had a condition imposed on his licence that required him to complete courses necessary to obtain the Chartered Life Underwriter designation or the Certified Financial Planner designation.[37]

Accordingly, in its decision, the Council imposed on the life agent's licence a requirement that the agent, following completion of his suspension, must successfully complete at least one course, per licence year, toward either a CLU® designation or a CFP® designation, until his successful completion of all of the courses required to attain either designation.

[35] The Canadian Insurance Regulators Disciplinary Actions database offers public access to regulatory decisions issued by insurance regulator members of CISRO and CCIR. The database is at http://decisions.cisro-ocra.com/ins/en/nav.do.

[36] *In the Matter of the Financial Institutions Act (R.S.B.C. 1996, C.141) (The "Act") and The Insurance Council of British Columbia ("Council") and Grant Sheldon Persal* (May 1, 2014). Online at http://decisions.cisro-ocra.com/ins/bcic/en/item/71642/index.do?r=AAAAAQAddW5zdWl0YWJsZSBmaW5hbmNpYWwgcGxhbm5pbmcB.

[37] *Ibid*., p. 8.

Similarly, in *In the Matter of the Financial Institutions Act and the Insurance Council of British Columbia and Wei Kai Liao* (December 30, 2014)[38], the advisor had two clients make complaints about the life and critical illness policies he had sold, in addition to investment loan/leveraged investment recommendations. The Council ordered that:

> A condition is imposed on the Licensee's life and accident and sickness insurance licence that requires him to successfully complete one of the following courses (the "Courses") during each of the next four licence periods commencing with the current licence period:
>
> a) Certified Financial Planner ("CFP") 231 - Financial Planning Fundamentals
> b) CFP 232 - Contemporary Practices in Financial Planning
> c) CFP 233 - Comprehensive Practices in Risk & Retirement Planning
> d) CFP 234 - Wealth Management & Estate Planning (page 2 of decision).

In 2012 Lambert John Schmid was found to have failed to conduct a sufficient needs analysis in selling life policies to a married couple. Among other disciplinary measures, the Council imposed on Schmid's life and accident and sickness insurance licence the requirement that he successfully complete all of the courses in Advocis' Best Practices program, or a similar program approved by the Council.[39] If these cases are not regulatory recognition of life-licensed advisors providing financial planning, then it is hard to see just what would qualify as financial planning. Given the foregoing analysis, Advocis would therefore suggest the Expert Committee revise *Recommendation 7a*, so that it reads as follows:

> 7 a. A similar and familiar regulatory framework and approach to overseeing individuals or entities selling similar products <u>and providing financial advice</u> within its jurisdictional oversight (e.g., mutual and segregated fund dealers, insurance agents, insurance brokers, and applicable sales staff within financial institutions, such as banks).

5. The Financial Services Tribunal

[38] Online at http://decisions.cisro-cra.com/ins/bcic/en/item/100203/index.do?r=AAAAAQAEbGlhbwE.

[39] *In The Matter of the Insurance Council Of British Columbia ("Council") Report of Council in the Matter of the Financial Institutions Act (The "Act") (R.S.B.C. 1996, C.141) and Lambert John Schmid* (March 5, 2012). Online at http://decisions.cisro-ocra.com/ins/bcic/en/63693/1/document.do.

The Expert Committee made six specific recommendations with regard to the FST. In addition to having its own budget, separate from that of FSRA, the FST would have a permanent Chair and at least two Vice-Chairs, supported by a roster of part-time adjudicators. The scope of the FST's jurisdiction would depend on the jurisdiction ultimately assumed by the FSRA, but the FST would hear appeals from FSRA decisions. The panel also suggested that, if appropriate, the FST could serve a broader adjudicatory function within the retail financial sector. To do so, the FST should have clearly articulated authority to adjudicate matters reflective of the jurisdiction of the FSRA, including appeals from certain statutory decisions made by the FSRA. Consideration should be given to whether the FST could also serve an adjudicative function for any relevant and appropriate regulatory matters impacting the broader financial services sector, if desirable. As well, a "mechanism and/or process should be established to appropriately permit, encourage and facilitate policy-level discourse between the FST and FSRA's Board of Directors."[40] Finally, the panel suggested that the Legislature "strive to ensure that the courts defer to the FST on policy or other matters that are within its subject-matter expertise."

Advocis has several concerns with regard to the FST. First, we would urge that the FST ensure that each sector under the FST's purview have its own FST adjudication channel, so that pension experts staff FST pension panels, insurance experts sit on FST insurance panels, etc. Second, we would suggest that a DAA function as an initial forum for the identification and potential resolution of disputes, after which the dispute could be sent to the Ombudsman or the FST, as appropriate. At a minimum, we would suggest that the DAA could function as an initial dispute resolution forum for disputes involving small sums of money which fall below the premium threshold of an advisor's professional liability insurance. This would free up the FST to devote more resources to major cases, while positioning the DAA to be able to gather information on younger or novice advisors who may be at risk of committing major mistakes, by being able to identify errors and risky behaviour at an earlier stage in the advisor's career, when the infractions committed tend to be of a lesser magnitude.

CONCLUSIONS AND NEXT STEPS

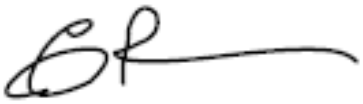
The underlying purpose of our earlier submissions to both this expert committees and the one on financial advisory and planning policy options is to provide a long-term model for the oversight of

[40] *Preliminary Position Paper*, *op. cit*., p. 15.

the advisor-client relationship. Such a program must result in comprehensive, efficacious, and cost-effective consumer protection in the financial services sector. We believe that the Ontario government can achieve this in part through the creation of an industry-wide delegated administrative authority for consumer-facing individual intermediaries. Ontarians have recently seen the release of several long-awaited reports – including the *Brondesbury Report* on the merits of fee-based versus commission-based mutual fund compensation, the OSC/IIROC/MFDA "Mystery Shopping" report, and the *Cumming Report* on mutual fund fees and performance – all of which point to drawbacks in our current set of financial products and services. But, most critically, we have yet to see a report from the Ontario government or one of its regulators about the value of advice for Ontarians. Indeed, we still see no effort by the province's regulatory authorities to try to understand, assess and harness the value inherent in the long-term advisor-consumer relationship. We hope that in the next stage of its review, the Expert Committee will introduce measures into its general framework which will recognize the value of this relationship, and its potential for addressing many of the financial and regulatory challenges Ontarians must now confront.

Advocis would be pleased to offer further comment or assistance on this matter at any time in the future. To discuss any of the issues that we have raised, please contact the undersigned or Ed Skwarek, Vice President, Regulatory Affairs and Public Affairs, at 416-342-9837 or at eskwarek@advocis.ca.

Sincerely,



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