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CCIR Secretariat
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Re: Segregated Funds Working Group Issues Paper, May 2016

Dear Sirs/Madam,

We are writing in response to the CCIR's recent paper on segregated funds.

1. The need for an industry-generated segregated funds policy.

Advocis supports the CCIR in reviewing current industry policies on suitability and disclosure obligations in the sale of segregated funds. We believe that the goal of any such review should be to determine whether it is feasible to create and then maintain a "level playing field" for advisors and other stakeholders, such as insurers and managing general agents. But we must always recognize – and we insist that regulators should, too – that segregated funds are an insurance product, and therefore should continue to be governed by a principles-based regime, and not be subjected to a securities-style one.

2. Suitability: Enhanced suitability requirements for segregated funds have the potential to make clients better informed and to lead to better consumer outcomes.

The needs-based analysis set out in CLHIA Reference *Document IVIC Suitability Needs-Based Sales Practices* (February 2013) provides a fulsome discussion of relevant suitability guidelines for IVIC sales. CHLIA Guideline G2, *Individual Variable Insurance Contracts relating to Segregated Funds*, sets out requirements in a number of important areas, including pre-sales disclosure, contract formation and policy delivery, and so on.

Also relevant is the CLHIA/IFB/Advocis document “The Approach,” which provides needs analysis criteria. Appendix One of FSCO’s September 2014 *Life Insurance Product Suitability Report* sets out in flowchart form the process of ensuring suitability at the point-of-sale (a process composed with assistance from Advocis, including input from its members).

However, only in Ontario does Guideline G2 have the force of provincial law. The main problem is the absence of mandatory uniform suitability requirements across Canada. The remedy, we believe, lies not in additional regulation, but in the adoption of comprehensive IVIC suitability criteria, in the form of an easy-to-use suitability checklist (see the attached document entitled “IVIC Suitability: Needs-Based Analysis of Client”).

In addition, we note that there are legitimate concerns over the increased compliance burden faced by advisors. There is a risk that segregated funds distribution could be negatively affected if advisors and other intermediaries involved in the distribution process (including its supervision), decide that the expenditure of resources needed to comply with the applicable regulation is too great. Care must be taken by regulators to ensure that enhanced suitability obligations, if introduced, do not simply prolong the sales process, with no benefit to either the advisor or client.

3. Disclosure: The creation of a CRM2-style process of annual reporting for segregated funds.

(a). Our general principle – disclosure should yield similar consumer outcomes:

As a general principle, the impact on the consumer of point-of-sale and ongoing/annual disclosure for segregated funds should be consistent with that which results from CRM2’s reporting obligations. Several observations must be made in support of this principle, including the facts that:

- the consumer is concerned with the dollar and percentage amounts that he or she pays at the point of sale and on an ongoing basis (ongoing fees should be reported every 12 months);
- the consumer should understand the costs associated with the variable insurance contract and its associated segregated fund options; and
- the consumer should be informed of the services he or she will get in return for the IVIC’s various ongoing fees and charges; disclosure of the fees and charges that the consumer pays, including the amount of the trailing commission, should be done in an advisor-client conversation which sets out the costs of ongoing service and advice regarding the segregated fund’s various contractual features (e.g., death benefit and minimum amount guarantees, resets, etc.) and the advisor should demonstrate to the client the “total value” that comes with the IVIC – e.g. the role of the advisor and the value of advice, the ongoing peace of mind afforded by the insurance guarantee and future annuitized income, etc.

(b). The regulation of disclosure needs to be informed by the following basic principles:

An acceptance of what disclosure can't do: It cannot create a regime of reporting obligations for (1) performance and (2) for fees, charges and compensation, which can be applied seamlessly to both segregated funds and mutual funds. It is not possible to create a means of comparing, for example, all fees and charges associated with a segregated fund and its variable insurance contract which corresponds on an “apples-to-apples” basis with all the fees and charges associated with a mutual fund.

A commitment to what disclosure realistically can and should do: It should help enable the consumer, working with his or her advisor to foster, in a standardized fashion, the following:

- evaluation of the product's features and benefits: in an easy, accurate and timely manner to determine and then compare the costs and benefits of the IVIC and its underlying segregated fund options in relation to the consumer's needs;
- inter-product comparisons: to compare an IVIC and its underlying segregated fund options with other the contractual features of other IVICs and their underlying segregated fund options;
- to compare an IVIC and its underlying segregated fund options with other variable insurance contracts and their underlying investment options (e.g., GICs, derivative contracts, etc.); and
- cross-sector comparisons: insofar as it is, first, conceptually possible, and second, feasible and practicable to do so, to compare the IVIC and its underlying segregated fund options with other investment products – mainly, mutual funds and exchange-traded funds.

(c). Advocis' reform recommendations:

We believe that current point-of-sale disclosure requirements for segregated funds are largely sufficient. With regard to the introduction of CRM2-style annual statements for delivery to IVIC policy owners, we believe that two types of reform should be explored:

- annual disclosure should be made to the IVIC policyholder of all the fees and charges he has paid to the product dealer and advisor (e.g., insurer and life agent) over a 12-month period; and
- annual disclosure should be made to the IVIC policyholder regarding the annual change, and change since the contract was opened, in the market value of the client's notional units in the segregated funds associated with his variable insurance contract, as well as the changes to the value of the insurance guarantees.

We would note that the risk of promoting client confusion through excessive and potentially misleading disclosure must be guarded against. There is also a risk of consumer harm if IVIC sales could drop because consumers wrongly decide that segregated funds are simply too costly and complex a means of addressing their needs.

4. Regulatory arbitrage.

Regulatory arbitrage, either in the form of advisors electing to sell segregated funds in lieu of mutual funds to avoid MFDA discipline, or to access the higher fees which come with an IVIC, is an acknowledged problem. But another form of regulatory arbitrage exists, one which is driven by “compliance fatigue” in the mutual funds sector. Experienced advisors may elect to abandon the mutual fund industry because of its higher compliance burden. The near-continual increase in the aggregate compliance burden from a wide range of reform obligations that is being placed on advisors in the securities sector has led many advisors to relinquish their MFDA licence and sell only segregated funds.

This does *not* mean that advisors who have abandoned the sale of mutual funds and at present sell segregated funds are engaged in mis-selling. We are not asserting that such advisors are disregarding the needs-based analysis and suitability requirements of the IVIC sales process in a self-serving effort to access the higher fees available with segregated funds.

We are saying that experienced advisors are restricting the nature of their practices in order to lessen their compliance burden. This does not make an attractive situation for the next generation of advisors. While, like the CCIR, we only have anecdotal evidence that this is a problem, we believe that the industry should take steps to empirically determine the scope of the problem and seek stakeholder input on how to mitigate it.

Advocis — Who We Are

Advocis is the largest and oldest professional membership association of financial advisors and planners in Canada. Through its predecessor associations, Advocis proudly continues over a century of uninterrupted history serving Canadian financial advisors and their clients. Our 12,000-plus members, organized in 40 chapters across the country, are licensed to sell insurance products – including segregated funds – mutual funds and other securities. Advocis members provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit planning, disability coverage, and long-term care and critical illness insurance to millions of Canadian households and businesses.

As a voluntary organization, one established by an Act of the federal Parliament, Advocis is committed to professionalism among financial advisors. Advocis members adhere to our published *Code of Professional Conduct*, uphold standards of best practice, participate in ongoing continuing education programs, maintain professional liability insurance, and act in their clients’ best interest. Across Canada, our members spend countless hours working one-on-one with individual Canadians on a gamut of financial matters. In addition, Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future. The values and goals of protecting and promoting client service, client education, the client’s freedom of choice, and of affording priority to the

client’s interest as it exists in the totality of the advisor-client relationship, represent the principles which inform much of our following analysis and argument. Accordingly, what follows reflects the priorities of Advocis’ members and their clients.

The submission that follows reflects the interests and views of those financial advisors in Ontario who are members of Advocis, and their clients, who are Ontarians from all walks of life.

I. ADVOCIS’ GENERAL POSITION ON THE CCIR’S SEGREGATED FUND PROPOSALS

With regard to Questions 1 to 17 of the CCIR Segregated Funds Working Group’s *Issues Paper*, we believe that with a series of modifications, the existing CLHIA guidelines may be rendered largely sufficient to the task of regulating segregated funds in a manner appropriate to the needs of the Canadian consumer. Guideline G2, *Individual Variable Insurance Contracts Relating to Segregated Funds*, has the force of law in Ontario through Ontario Regulation 132/97 (*Variable Insurance Contracts*), and we would encourage other provincial and territorial jurisdictions to adopt it. We set out below in detail several proposed methods of enhancing current disclosure to IVIC policy holders, to bring it more in line with the consumer outcomes that are the goal of the annual client statements mandated by the last stage of Phase II of the CSA’s Client Relationship Model (CRM2).

Our view of the task at hand

At present, the consumer who purchases a segregated fund receives a wealth of information, both at or before the sale and during the period he holds the contract. During the period leading up to and including contract formation, which involves a consultation between the consumer and the licensed life agent, the consumer receives a copy of the variable insurance contract and the segregated fund’s Information Folder. After purchase, the client receives trade confirmations which indicate the contract type he has purchased, the funds selected, and other fund- and trading-related information and, later, semi-annual and annual financial statements, and at tax time the relevant tax slips and official tax receipts. Given this wealth of disclosure, we believe that any reform efforts by the CCIR need only to be relatively minor amendments – essentially, efforts at “gap-closing.” Given the large amount of current disclosure, and given the number of “legacy” IVICs in the accounts of Canadians, we strongly urge the CCIR to adopt an incremental approach, characterized by wide stakeholder consultation, prior implementing to any reforms in this area.

Facilitating practical “apple-to-apples” between segregated funds and mutual funds

Advocis believes that the consumer disclosure outcomes being sought for mutual fund investors under CRM2 should be sought for segregated fund owners, and that segregated funds should use some of the same reporting and classification methodologies which the CSA proposes. The result should be a consistent, cross-sector reporting system, so that:

1. accurate comparisons between segregated fund A and segregated fund B can be made quickly on the basis of common measurement categories; and
2. comparisons between segregated fund A and mutual fund A can be made quickly and as accurately as possible across as many common measurement categories as is practicable.

In other words, the goal should be to ensure that comparisons are done on a consistent “apples-to-apples” basis. This will require uniform information to be provided to clients at the point of sale and/or annually, including:

- the various insurance coverage options available;
- the cost of those coverage options; and
- disclosure of initial and ongoing fees and charges.

The provision of information to consumers should be conducted according to three principled requirements, which are to:

- provide the consumer with key information about the variable insurance contract and the underlying funds;
- provide that information in a simple, accessible and comparable format; and
- provide the information and review it with the consumer before the purchase transaction.

These are the principles which inform our answers to the CCIR’s specific questions, to which we now turn.

II. ADVOCIS’ SPECIFIC RESPONSES TO THE CCIR’S QUESTIONS

Issue 1. Charges and Compensation Reports

Question 1. What enhanced disclosure of charges and other compensation for IVICs would encourage intermediaries and consumers to examine more closely the products recommended and purchased? Please explain.

Advocis’ Answer. To begin, we note that CLHIA *Guideline G2, Individual Variable Insurance Contracts Relating to Segregated Funds*¹, requires that the management expense ratio (MER) be disclosed in the Fund Facts document and that a more detailed exposition of the IVIC’s fees, costs and expenses be set out in the Key Facts document. We suggest the use of brief, bolded text and the use of graphical illustrations in our proposed annual reporting for IVICs, in order to help consumers quickly and even

¹ CLHIA, *Guideline G2 Individual Variable Insurance Contracts Relating to Segregated Funds*, January 2011. Online at [www.clhia.ca/domino/html/clhia/clhia_lp4w_ind_webstation.nsf/resources/Guidelines/\\$file/Guideline_G2.pdf](http://www.clhia.ca/domino/html/clhia/clhia_lp4w_ind_webstation.nsf/resources/Guidelines/$file/Guideline_G2.pdf).

intuitively grasp the main points of difference between a segregated fund and a mutual fund, and to clearly display with a sense of visual immediacy the value of the segregated fund's own unique features for the consumer. We believe that providing more detailed textual information in the Key Facts will help the advisor explain to the consumer how the cost elements of the MER are calculated; this will help consumers see *why* segregated fund MERs are higher than mutual fund MERs, and detailed visual information which decomposes the elements of the MER – in the Fund Facts (room permitting) or in the Key Facts – will help the consumers see how much they pay annually for the peace of mind the insurance guarantees bring them, as well as for the ongoing advice and service they receive.

Our answer to Question 1 is that, in addition to the Fund Facts document that comes with a segregated fund, disclosure of certain other cost information is desirable, including a breakdown of the MER. A graphical breakdown of the MER – e.g., in the form of a pie chart – will help show the consumer the amount he or she pays for the insurance guarantees. This is in effect the cost of the “peace of mind” of removing from the realm of pure investment risk a percentage of the client's asset. Ideally, this would be done in the Fund Facts document (see Item 2 and the highlighted text in Figure One, below, for an example). It may be the case that considerations of space would relegate any MER pie chart to the Key Facts document.

Pre-sale: Overall, from a point-of-sale perspective, we believe that some minor adjustments to the Fund Facts and the Key Funds sheets would lead to improved consumer understanding of the “value-for-cost” of a segregated fund and, in particular, its unique insurance features.

Fund Facts: The reporting of the MER in the Quick Facts box at the top of the first page of the Fund Facts sheet should mention that the MER includes the costs of the IVIC's insurance features and list what they are. The Quick Facts box should have a line which indicates that the insurance costs directly affect the size of the MER. In the (rare) event that the insurer has opted to report the insurance costs separately from the MER, those costs should still be reported in the Quick Facts box. See the highlighted text in Item 8 entitled “2. Ongoing fund expenses” in Figure One, below.

In addition, we believe that there should be a statement on the Fund Facts to the effect that:

A segregated fund is an insurance contract with an investment component. This makes any attempt to compare the costs and benefits of this fund with those a mutual fund or exchange-traded fund an exceptionally complicated task. **Consumers should consult with their advisor before attempting such a comparison.**

Key Facts: Here we believe that the section on the MER should include, in the section entitled “How much will this cost?” a graphical breakdown of the MER – e.g., in the form of a pie chart – to help show

the consumer the amount he or she pays for the insurance guarantees. This is in effect the cost of the “peace of mind” of removing from the realm of pure investment risk a percentage of the client’s asset.

Consideration should be given to permitting insurers the option to include a “benchmark MER” of a hypothetical, industry-average segregated fund, one which is of the same class as the actual segregated fund under consideration.

Also for consideration: whenever a segregated fund begins a reporting year and it has a counterpart mutual fund with identical holdings, then a comparative chart showing the MERs of each fund could be added at the company’s discretion. (Note that the risk classifications and the performance measures of the funds could be radically different, depending on when they were rebalanced, etc.). Again, this would show in visual fashion why the segregated fund’s MER is higher, and so the consumer could see, all other things being equal, that most elements of the segregated fund’s MER are approximately identical to those of the mutual fund, with the difference chiefly being the extra insurance features that come with the segregated fund. The rationale for these proposals is to assist investors in making informed decisions, and they need to have a basis of comparison to do this effectively.

Post-sale: From a post-sale perspective, we recommend slight modifications to the CLHIA’s existing annual reporting requirements for segregated funds – which are set out in *Guideline G2, Individual Variable Insurance Contracts Relating to Segregated Funds*. In order to introduce a degree of CRM2-style reporting for segregated funds – insofar as the differences between the products make it feasible to do so – the CCIR should mandate the introduction of a CRM2-based *Annual Costs and Other Charges Statement* for IVICs. This report could be a separate section on the existing segregated fund’s *Annual Report to the IVIC Contract Holder*, or it could be a separate disclosure form, delivered in conjunction with the annual statement.

Reporting of ongoing charges and other compensation: To replicate for the IVIC holder the impact that CRM2’s annual reporting will have for mutual fund investors, we recommend that that segregated fund’s *Annual Report to the IVIC Contract Holder* include a section entitled “Charges You Paid Directly To Us” which lists as line items the various administrative, operational, and transactional (for trades and switches) fees and expenses. As well, the ongoing compensation costs – typically, a trailing commission, and any DSC charges incurred – should appear in a subsequent section entitled “Compensation We Received From Third Parties.” (All of these sections would be roughly analogous to the sections and individual line items in CRM2’s *Annual Report on Costs and Other Charges*).

Delivery requirements: Again, to create for the IVIC owner the impact that CRM2’s annual reporting of charges will have on the mutual fund investor, the IVIC owner will have to receive annually a charges and compensation report for each variable insurance contract he or she owns. In terms of delivery

requirements, then, the insurer should be responsible for ensuring that the IVIC policyholder receives a *Costs and Other Charges* report on an *annual* basis for *each* segregated fund account. If the insurer is able to, and the client agrees in writing, it should be permissible to consolidate the separate IVIC account statements into a single document.

Please see below for an extended discussion of the Fund Facts document and possible ways to create a CRM2-style costs and compensation disclosure form. We do not address in any detail the issue of varying distribution costs on the insurance side versus those on the fund side; such a discussion will require participation from a range of IVIC and mutual fund manufacturers, dealers and other distributors.

Question 2. How else might better disclosure and transparency be achieved by the IVICs industry?

Advocis' Answer. We set out in our answers to Questions 5 and 11 how a more uniform degree of performance reporting and risk disclosure for segregated funds can be implemented. More generally, we note that CLHIA Guideline G2 has the force of law in Ontario, by way of Ontario Regulation 132/97 (*Variable Insurance Contracts*). We would encourage the CLHIA to request other provinces and territories that they incorporate Guideline G2 into their provincial/territorial insurance legislation in a similar manner.

REVIEW OF DISCLOSURE AND REPORTING ISSUES CENTRAL TO QUESTIONS 1 AND 2

A. Amendments to the IVIC's Summary Disclosure Documents at the Point-of-Sale

As summary disclosure documents, we believe that an IVIC's Fund Facts and Key Facts should do three things:

- (1) breakdown the MER for the consumer;
- (2) ensure the consumer understands the relations among the MER, the insurance guarantees and their costs, and the account's annual performance, net of costs and charges; and
- (3) highlight the importance of the advisor's role.

(i). **Summary of current disclosure requirements.**

The consumer must receive the current Fund Facts document for each segregated fund he selects for his IVIC, as well as a Key Facts document. A Fund Facts form is required for every version or variant of a fund which has a separate MER – for example, fund series, classes and guarantee options. The Key Facts document explains the key features and benefits of a segregated fund's underlying investments and the basics of the variable insurance contract to potential policyholders. Taken together, the Fund Facts and

Key Facts documents present information in easy-to-understand formats, and in a manner fairly consistent across the industry, in order to assist consumers in, first, understanding the basics of the IVIC's linked investments and its main contractual features and, second, in making comparisons across products. Finally, their content is written in a consumer-friendly style, which makes it easy for advisors to use the document with clients and prospects at the point of sale and during ongoing or annual reviews.

(ii). The consumer should understand the link between the segregated fund's MER and the cost of the insurance features.

Even a cursory review on the Web of the Fund Facts and Key Facts in the Information Folders of major distributors across Canada reveals that most Fund Facts and Key Facts convey to consumers a critical piece of information essential to effective consumer decision-making: the direct relationship between insurance guarantees, the MER, and the annual growth of the notional units of the segregated fund. However, minor variations in wording and occasional omissions also turn up in such a survey, which may suggest the need for a more stringent effort by insurers or intermediaries at explicating the impact of the insurance guarantee's costs on the MER, and of the MER on annual unit value.

It is general industry practice to include the insurance costs in the MER information that is reported in the Fund Facts. However, the insurance costs *may* be shown as part of the MER *or* listed separately – section 11.4 (g) of CHLIA Guideline states that:

(g) Insurance Fees:

- (i) The Insurer may include an insurance fee as part of the management fee charged against the assets of the segregated fund or may separate it from the management fee. "Insurance fee" means an amount charged by the insurer with respect to the provision of insurance features of the individual variable insurance contract.
- (ii) If an Insurer separates the insurance fee from the management fee charged against the fund, then the insurer shall state in its information folder both the current insurance fee to be charged to each segregated fund and an insurance fee limit for each segregated fund . . .

Given that almost all Fund Facts we have reviewed include the insurance costs in the MER, we wonder if mandating uniformity of reporting in this regard might be desirable. As a practical matter, a segregated fund's MER is typically reported to the consumer as composed of the:

- management fees and administrative and operating expenses of the fund (as with mutual funds);

- the HST, capital taxes, and interest expense (as with mutual funds), expressed as a percentage of the average net assets during the year; and,
- the insurance fees – the cost of the death benefit and maturity guarantees.

As we will discuss, the MER and its constituent elements are shown only in numerical format, and we believe that the addition of a pie chart graphic will let consumers quickly and easily grasp the annual cost of the reassurance or peace of mind that the segregated fund provides them in the form of the death benefit and maturity guarantees. Indeed, to *not* display such crucial component of the segregated fund in a more accessible format may be something of a disservice to the novice or inexperienced consumer.

(iii). Breaking out the individual elements of a segregated fund’s MER.

Since the advent of the Joint Forum project in 1999, a small but not insignificant cohort of stakeholders has repeatedly expressed concerns that embedding the costs of the insurance guarantees in the MER only confuses consumers. Currently, the MER is disclosed in the Fund Facts and broken down into its main categories, since this information is of direct relevance to the consumer.

The main reason for disaggregating or otherwise highlighting the insurance guarantees in a segregated fund is to allow the consumer to decide whether or not to insure a portion of his assets. It is of practical value to consumers at the pre-sale stage to see the costs of the death benefit guarantee and the capital guarantees as separate items. Knowing the insurance costs, the consumer can with an advisor evaluate the cost *vis-à-vis* other forms of insurance, and more easily compare the segregated fund’s MER (minus its insurance costs) other those of other mutual funds. The goal is to show to the consumer a basic set of numbers which represent the MER categories which matter to him for comparative purposes, as well as a number which represents the overall cost he pays for the IVIC, so that he has at hand accurate and understandable figures (numerically, and in graphical format, when possible) for comparing the costs of a segregated fund with:

1. with the costs of other investments available within an IVIC, such as a guaranteed income certificate;
2. with the costs other segregated funds available within other IVICs; and
3. with certain MER component costs associated with mutual funds with substantially similar or identical holdings, in order that he and the advisor may compare the attractiveness of the IVIC with the costs of purchasing a mutual fund and buying other forms of insurance, or foregoing insurance altogether.

(iv). There are unavoidable roadblocks in any effort to quickly compare the cost of an IVIC to that of a mutual fund.

With regard to point 3., above, it must always be emphasised that the process of comparing mutual funds to segregated funds is one which is subject to extensive qualification, and that an effort to make an item-by-item MER-based comparison which seeks an “apples-to-apples” outcome quickly runs into a set of incommensurable data points. Indeed, it should be borne in mind that comparing the costs of a segregated fund with that of a mutual fund is more of an art than a science.

We are not saying that further insurance costs breakdown will reveal the final, absolute “base cost” of the segregated fund (and its underlying mutual funds) for a number-to-number, straight-up comparison between the IVIC and the mutual fund. We believe that there should be a statement on the Fund Facts to the effect that:

A segregated fund is an insurance contract with an investment component. This makes any attempt to compare the costs and benefits of this fund with those a mutual fund or exchange-traded fund an exceptionally complicated task. Consumers should consult with their advisor before attempting such a comparison.

This brings us to the final point of our thoughts on disclosure reform for the Fund Facts and Key Facts documents.

(v). Summary disclosure documents should clearly state the utility to the consumer of professional financial advice beyond the point of sale.

Many consumers struggle with understanding the consequences for their estate planning of the insurance guarantees, the associated tax issues, and so on. Again, the Fund Facts should expressly state the need to consult with one’s financial advisor.

The next two sections attempt to set out the thinking outlined in (i) to (v), above.

B. Revisiting the Fund Facts for a Segregated Fund

FIGURE ONE. REPORTING OF THE MER IN A SEGREGATED FUND’S FUND FACTS SHEET.

| FUND FACTS FOR SEGREGATED FUND | | | | | | | | | | | | | | | | | | | | | | | | | |
|---|---|--|-------|-------------------|-----------------|---------|---|--------------------|----------|---|------------------|----------|---|--------------------------|----------|-----|--|----------|-------|-----------------|------|--------------------|------|------------------|------|
| Item 1 | Full Legal Licensed name of the Insurance Company Date of Information | Name of the Segregated Fund Product Name of the Segregated Fund | | | | | | | | | | | | | | | | | | | | | | | |
| Item 2 | <p>Quick facts</p> <p>The MER of this segregated fund is calculated based on the insurance fees, the management fees and operating expenses. The MER includes the MERs of any underlying funds, and any fees or charges associated with those underlying funds. There is no duplication in the fees or sales charges of the funds and underlying funds.</p> | | | | | | | | | | | | | | | | | | | | | | | | |
| | <p>ABC Canadian Growth & Income Segregated Fund</p> <table border="1"> <caption>ABC Canadian Growth & Income Segregated Fund - Fee Breakdown</caption> <thead> <tr> <th>Category</th> <th>Value</th> <th>Percentage of MER</th> </tr> </thead> <tbody> <tr> <td>management fees</td> <td>100 bps</td> <td>-</td> </tr> <tr> <td>operating expenses</td> <td>0.40 bps</td> <td>-</td> </tr> <tr> <td>transaction fees</td> <td>0.20 bps</td> <td>-</td> </tr> <tr> <td>insurance guarantee fees</td> <td>0.37 bps</td> <td>19%</td> </tr> </tbody> </table> | Category | Value | Percentage of MER | management fees | 100 bps | - | operating expenses | 0.40 bps | - | transaction fees | 0.20 bps | - | insurance guarantee fees | 0.37 bps | 19% | <p>ABC Canadian Growth & Income Mutual Fund</p> <table border="1"> <caption>ABC Canadian Growth & Income Mutual Fund - Fee Breakdown</caption> <thead> <tr> <th>Category</th> <th>Value</th> </tr> </thead> <tbody> <tr> <td>management fees</td> <td>1.0%</td> </tr> <tr> <td>operating expenses</td> <td>0.4%</td> </tr> <tr> <td>transaction fees</td> <td>0.2%</td> </tr> </tbody> </table> | Category | Value | management fees | 1.0% | operating expenses | 0.4% | transaction fees | 0.2% |
| Category | Value | Percentage of MER | | | | | | | | | | | | | | | | | | | | | | | |
| management fees | 100 bps | - | | | | | | | | | | | | | | | | | | | | | | | |
| operating expenses | 0.40 bps | - | | | | | | | | | | | | | | | | | | | | | | | |
| transaction fees | 0.20 bps | - | | | | | | | | | | | | | | | | | | | | | | | |
| insurance guarantee fees | 0.37 bps | 19% | | | | | | | | | | | | | | | | | | | | | | | |
| Category | Value | | | | | | | | | | | | | | | | | | | | | | | | |
| management fees | 1.0% | | | | | | | | | | | | | | | | | | | | | | | | |
| operating expenses | 0.4% | | | | | | | | | | | | | | | | | | | | | | | | |
| transaction fees | 0.2% | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>The MER of the ABC Canadian Growth & Income Segregated Fund is higher than the MER of the ABC Canadian Growth & Income Mutual Fund with identical holdings, because of the insurance guarantees of 0.37%.</p> | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Guarantee policy | MER (Annual rate as a % of the fund's value) | | | | | | | | | | | | | | | | | | | | | | | |
| | Option 1: 75% maturity and 75% death benefit guarantee | 2.73 | | | | | | | | | | | | | | | | | | | | | | | |
| | Option 2: 100% maturity and 100% death benefit guarantee | 2.89 | | | | | | | | | | | | | | | | | | | | | | | |
| Item 8 | <p>How much does it cost?</p> <p>The following tables show the fees and expenses you could pay to buy, own and sell units of the fund.</p> | | | | | | | | | | | | | | | | | | | | | | | | |

| | |
|--|--|
| | The ongoing fees and expenses are different for each guarantee option. |
|--|--|

| 2. Ongoing fund expenses | | | | | | | | | | | | | |
|---------------------------------|--|------------------|---|--|--|-------|----------|--|--|------|------------|--|--|
| Item 8 | The management expense ratio (MER) includes the management fee and operating expenses of the fund. Segregated fund MERs typically incorporate the cost of the insurance guarantees, making them higher than those of mutual funds. MERs vary by fund. The MER includes the insurance cost for the guarantee. [Or: A separate insurance fee is charged for the guarantee.] You don't pay these expenses directly. They affect you because they reduce the return you get on your investment. For details about how the guarantees work in conjunction with the MER, see the chart below and the relevant section of your insurance contract, and contact your advisor. This fund's MER is based on the December 31, 2016 audited financial statements. The most up-to-date information is available on www.segfundco.ca . | | | | | | | | | | | | |
| | <table border="1" style="width: 100%;"> <thead> <tr> <th style="width: 20%;">Guarantee Option</th> <th colspan="3">MER (Annual rate as a % of the funds value)</th> </tr> </thead> <tbody> <tr> <td>Basic</td> <td>75/75 X%</td> <td></td> <td></td> </tr> <tr> <td>Full</td> <td>100/100 X%</td> <td></td> <td></td> </tr> </tbody> </table> | Guarantee Option | MER (Annual rate as a % of the funds value) | | | Basic | 75/75 X% | | | Full | 100/100 X% | | |
| Guarantee Option | MER (Annual rate as a % of the funds value) | | | | | | | | | | | | |
| Basic | 75/75 X% | | | | | | | | | | | | |
| Full | 100/100 X% | | | | | | | | | | | | |
| | | | | | | | | | | | | | |

C. Reporting the IVIC's Costs and Charges in the Annual Statement to the IVIC Contract Holder

Implementation of the annual account statements for mutual funds under Phase Two of CRM2 will lessen the dissimilarity that currently exists between segregated funds and mutual funds in regard to investor disclosure. At present, there is only a moderate degree of similarity between the mandated disclosures required for segregated funds and those required for mutual funds, due to the common Fund Facts requirement.

But with the delivery of the first of CRM2's annual account statements, the *Costs and Other Compensation* report, consumers will soon develop a better understanding of the fees they are charged for a mutual fund than for a segregated fund. And once the first annual reports under CRM2 are in the hands of clients, the information and disclosure asymmetries between the two products will become clearer. Indeed, as this day draws closer, calls to improve disclosure on the insurance side garner an additional impetus, with the sought-for outcome that a consumer should be able to easily compare the two types of product, determine what the fees represent, and discern the impact on their investment returns.

(i). CRM2’s Annual Report on Charges and Other Compensation. The essential costs disclosure contained in a CRM2 annual costs and charges report is set out in Figure Two, below, which is based on the template of the Canadian Securities Administrators.

FIGURE TWO. PORTION OF A HYPOTHETICAL CRM2 ANNUAL REPORT ON CHARGES AND OTHER COMPENSATION.

| Annual Charges and Compensation Report | | |
|--|-------|-----------------------------|
| [Name of Firm] | | |
| | | Your Account Number: 123456 |
| Client name | | |
| Address line 1 | | |
| Address line 2 | | |
| Address line 3 | | |
| <p>This report summarizes the compensation that we received directly and indirectly in 20XX. Our compensation comes from two sources:</p> <ol style="list-style-type: none"> 1. What we charge you directly. Some of these charges are associated with the operation of your account. Other charges are associated with purchases, sales and other transactions you make in the account. 2. What we receive through third parties. | | |
| <p>Charges are important because they reduce your profit or increase your loss from investing. If you need an explanation of the charges described in this report, your representative can help you.</p> | | |
| <u>Charges you paid directly to us</u> | | |
| RSP administration fee | \$100 | |
| Total charges associated with the operation of your account | | \$100 |
| Commissions on purchases of mutual funds with a sales charge | \$101 | |
| Switch fees | \$45 | |
| Total charges associated with transactions we executed for you | | \$146 |
| Total charges you paid directly to us | | \$246 |
| <u>Compensation we received through third parties</u> | | |
| Commissions from mutual fund managers on purchases of mutual funds (see note 1) | | \$503 |
| Trailing commissions from mutual fund managers (see note 2) | | \$286 |
| Total compensation we received through third parties | | \$789 |

Total dollar amount of operating and transaction charges.

Dollar amount of trailing commissions or similar compensation.

Total charges and compensation we received in 20XX **\$1,035**

Notes:

1. When you purchased units of mutual funds on a deferred sales charge basis, we received a commission from the investment fund manager. During the year, these commissions amounted to \$503.
2. We received \$286 in trailing commissions in respect of securities you owned during the 12-month period covered by this report.

Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing commission depends on the sales charge option you chose when you purchased the fund. You are not directly charged the trailing commission or the management fee. But, these fees affect you because they reduce the amount of the fund’s return to you. Information about management fees and other charges to your investment funds is included in the prospectus or fund facts document for each fund.

A single number is meant to provide the sum total of all costs paid by the client to the dealer for the mutual fund.

Our current schedule of operating charges:

- service charges
- administration fees
- safekeeping fees
- management fees
- transfer fees
- annual registered plan fees
- any other charges associated with maintaining and using an account that paid to us by you or by a third party on your behalf
- account closing fees

(ii). **An Application of CRM2 to an IVIC Policy Holders Annual Statement.** The following table sets out the major cost items which appear in the CSA’s CRM2 annual charges and costs report, and which would need to be replicated in an equivalent report for segregated funds. Since the goal of such a report is to align the segregated fund’s reporting with that required under CRM2, all fees paid in that year by the IVIC owner to the advisor and the insurer should be disclosed on it – as far as it is possible and practicable to accurately isolate and calculate the fees, charges and direct and indirect compensation payments.

TABLE ONE. PROPOSED ELEMENTS OF A SEGREGATED FUND’S ANNUAL COSTS AND CHARGES STATEMENT TO AN IVIC CONTRACT HOLDER.

| Cost/Charge Item | Mutual Funds | Segregated Funds | |
|--|--|---|---|
| Operating charges | Service charges, administration fees, safekeeping fees, management fees, transfer fees, account closing fees, and annual registered plan fees paid to the firm, plus sales taxes. | Fund manager’s fees, administration, legal and accounting fees, brokerage and audit fees, custodial fees, bookkeeping costs, plus sales taxes | |
| Transaction charges | Transaction fees, switch or change fees, performance fees, short-term trading fees, and sales charges or redemption fees that are paid to the firm, plus sales taxes. | Most insurers currently provide clients with the actual dollar amounts and breakdown trading fees for IVICs. For example: | |
| | | Trading fees apply to all guarantee options and are paid to SEG FUND CO. | |
| | | FEE | WHAT YOU PAY |
| | | Frequent Trading Fee | 2% of the value of units you trade for switches exceeding 5 per year. |
| Early Withdrawal Fee | 2% of the value of units you sell or transfer within 90 days of buying them | | |
| Charges specific to a mutual fund/segregated fund | Not applicable. | These are separate fees, and are not included in the investment management fees and other expenses: for example, the death benefit guarantee reset fee, maturity guarantee reset fee and the lifetime income benefit fee. | |
| Total annual dollar amount of trailing commissions and/or similar compensation paid to distributor by consumer or third party | The CRM2 Annual Costs and Other Charges Statement will show actual dollars amount of trailer, accompanied by a statement advising the client that the trailing commission is paid by investment fund managers, its amount varies depending on the purchase options selected, and that these fees impact the customer because they reduce the amount of the fund’s returns. | Some insurers currently provide clients on an annual basis with the actual dollar amounts and breakdown of fees for segregated funds. A new annual account statement should advise the IVIC policy owner in regard to who pays the advisor’s compensation, how it is paid (e.g., by commission) and in what amount(s). For trailing commissions and embedded compensation, the IVIC policy owner should be informed whether the commissions is paid by the insurer, or by another third party (such as an investment fund manager), | |

| | | |
|--|--|---|
| | | <p>that its amount can varies depending on the transactions conducted (i.e., DSCs) and other options the policy owner selected, and that these fees impact the policy owner because they reduce the amount of the fund’s returns. The policy owner should also be informed of both the commission’s dollar amount and its percentage value of the notional segregated fund units.</p> |
|--|--|---|

Figure Three, below, is a fairly straightforward representation of how these elements may be introduced into a hypothetical annual statement to an IVIC owner.

FIGURE THREE. A SEGREGATED FUND’S ANNUAL STATEMENT TO CONTRACT HOLDER, AMENDED IN LIGHT OF CRM2.

ANNUAL STATEMENT TO CONTRACT HOLDER

Charges you paid
 These are the fees and expenses you paid to buy, own and sell units of the fund. Each guarantee option also has its own ongoing fees and expenses.

1. Sales charges
 You can sell up to 00% of your units each year without paying a deferred sales charge.
 You are at year 6, so you pay a DSC of 0%. **In 2017, you paid 0% for a total of \$00.00**

2. Ongoing fund expenses
 The management expense ratio (MER) includes the management fee, cost of the insurance guarantees, and the operating expenses of the fund.

| Guarantee Option | MER (Annual rate as a % of the funds value) | |
|----------------------------|---|--|
| Basic: Death / Maturity | 75/75 X% | In 2017, you paid \$00.00 and \$00.00, for a total of \$00.00 |

Trailing commission
 XX pays your (advisor) a trailing commission for as long as you own the fund. It is for the services and advice your (advisor) provides to you. The trailing commission is paid out of the management fee.

**In 2017, you paid 00.00% of the value of your investment, for a total of \$00.00.
 Total Compensation We Received From You and From Third Parties: \$00.00.**

Trading and Switch Fees. You can switch to units of other funds under the insurance contract at any time without paying a deferred sales charge as long as you do not change your guarantee option. The deferred sales charge schedule will be based on the date you bought your first fund.

| Fee | What you paid |
|--|--|
| Short-term trading fee | X% of the value of units you sold, which totalled \$000.00. |
| | Short-term trading fees: In 2017, you paid 0%, for a total fee of \$00.00. |
| Change fee | X% of the value of units you transferred to another guarantee option of the fund, which totalled \$000.00. |
| | Change fees: In 2017, you paid 0%, for a total fee of \$00.00. |
| | Total Charges Associated with Transactions We Executed For You: \$00.00. |
| TOTAL CHARGES AND COMPENSATION WE RECEIVED: \$00.00 | |

Issue 2. “Soft Dollars” and other Sales Incentives

Question 3. What would be the most effective method of ensuring that IVIC consumers were aware of soft dollar arrangements and other sales incentives?

Question 4. How should insurers make sure that soft dollar arrangements and other sales incentives do not create conflicts of interest for intermediaries?

Advocis’ answer. It may prove to be the case that the issue of “soft dollars” has been effectively addressed by the recent decision of the Canadian Life and Health Insurance Association Inc. (CLHIA) to abandon the traditional sales conference for independent advisors. In its report on life insurance distribution, *Insurance Distribution in Canada: Promoting a Customer-Focused System*, the CLHIA called for changes to the incentives behind so-called “recognition conferences.” These conferences are intended to reward independent advisors who have generated large volumes of business. (It should be noted that this practice was banned some time ago in the mutual fund industry). It will of course be a necessity that the industry adheres to the principles underlying the CLHIA’s position, and does not simply replace one form of “soft compensation” with another.

In specific, the report said that travel incentives could contribute to a "perception of a conflict of interest" by potentially motivating insurance agents to sell a particular carrier's products over another's. In response, the CLHIA recommended that independent advisors should be required to pay their own travel and accommodation costs for such conferences. As a consequence of this recommendation, a number of major insurers have announced they will no longer host volume-based

incentive conferences in order to help ensure that advisors are operating without any perceived conflicts of interest.

Advocis agrees with the CLHIA’s position. Insurers which distribute through independent advisors should be allowed to offer only trips with “reasonable professional content,” as long as the advisors pay their own travel and accommodation costs. This eliminates any perception that advisors are placing contracts with a particular insurer in order to qualify for the conference and trip.

With regard to a dedicated sales force, we agree with the CLHIA’s report that there is no conflict when insurers cover advisors’ travel costs for trips to conferences with, again, “reasonable professional content.” For an advisor who is part of an insurer’s dedicated sales force, there is no incentive to recommend one insurer’s product over another. Similarly, managing general agents or MGAs should be allowed to offer expense-paid conferences, if qualifying for the conference is not tied to placing business with any particular insurer, and there is otherwise no incentive to recommend one insurer’s products over another.

It may be that a risk of mis-selling remains, for while national sales conferences will attract plenty of scrutiny in the wake of the CLHIA report, a local brokerage manager may have the budget room for a small, regional promotional event which could be effectively “under the radar” of even the manager’s head office. With that proviso having been made, we recommend that the CCIR endorse the CLHIA’s approach and monitor the situation to see if the proposed controls “stick.” Finally, as a general matter, we believe that disclosure of “soft dollar arrangements,” when they are permitted, should always be made by independent advisors, in order to eliminate the possible appearance that they may favour one segregated fund over another at the expense of the client.

Issue 3. Account Performance Reports for IVICs

Question 5. How should account performance reports for IVIC contract holders be harmonized with those on the mutual fund side? What adjustments could be made to take into consideration IVICs’ guaranteed protections?

Background.

A review of CRM2’s annual performance reporting requirements

CRM2 requires annual report information to be reported in a variety of easy-to-understand ways, including through the use of tables and charts. The CRM2 annual performance report shows the annual change in market value of the mutual fund, and the investor’s personal rate of return on a 1, 3 5, 10, and since account inception basis; these rates are calculated using a dollar-weighted methodology.

The current performance reporting standards for IVICs

Section 4.3, “Annual Statement to Contractholder,” of Guideline G2, *Individual Variable Insurance Contracts Relating to Segregated Funds*, sets out the current annual reporting obligations owed to an IVIC policy owner. The CLHIA’s requirements are as follows:

- **timing of statement delivery:** the insurer must provide to the contract holder, within four months of each successive fiscal year-end of the fund, an annual statement;
- **value of the insurance benefits:** section 4.3 (a) requires the reporting of “the value of the benefits under the contractholder's individual variable insurance contract related to the market value of the segregated fund at the end of the period covered by the statement”; and
- **value of the money allocated to the underlying segregated fund(s):** section 4.3 (b) requires reporting of “the amount, if any, allocated under the contractholder's individual variable insurance contract to a segregated fund during the period covered by the statement”; for “amount,” the industry has simply set out the dollar amounts allocated to the notional units of the segregated fund(s).

As for detailed performance reporting, the annual report to the IVIC holder need only provide that:

- **availability of information on performance reports: periods for overall rate of return, net of MER:** section 4.3 (c) states that “information regarding the current management fee, management expense ratio and the overall rate of return, calculated on a net basis for the segregated fund for the last 1, 3, 5 and 10 year periods, if applicable, are available upon request, together with contact information about how to obtain the statements”; and
- **reference to Fund Facts’ performance information:** section 4.3 (e) requires a statement that “current Fund Facts information is available upon request, together with contact information about how to obtain current Fund Facts information.” However, this requirement is not all that useful to the investor, since under current industry guidelines, Fund Facts documents for IVICs must include *only* the reporting of year-by-year return information and 10-year average return information.

Advocis’ answer. For mutual funds, the annual performance report required under CRM2 must state the fund’s annualized total percentage return. It must do so using a dollar-weighted methodology for 1, 3, 5 and 10-year periods, as well as since the account’s inception. The statements should be produced and distributed by the dealer firm.

Mandate performance reporting on a 1, 3, 5, 10 and since inception basis

Given the relative paucity of performance information that must actually be disclosed on an annual IVIC annual statement, Advocis believes that performance data should be enhanced so that the segregated

funds' performance metrics replicate, *as far as it is practicable to do so*, those in the CRM2 annual performance statement. The obvious first step is to change the current optional annual performance reporting requirement to a mandatory one. In order to facilitate for consumers the “apples-to-apples” comparison between segregated funds and mutual funds, we recommend that IVICs be *required* to show in the *Annual Report to the IVIC Contract Holder* their annualized total percentage returns, using a dollar-weighted methodology, for the 1, 3, 5 and 10-year periods, as well as since the contract's opening. We would also suggest that companies have the option of reporting some monthly data, given that volatility may affect the decision by a policy holder about if and when he should lock in his gains.

It would be useful for annual performance statement to also note that the personal rate of return reflects the policy holder's own unique investment performance, less the MER (mainly trading and investment management costs). It is valuable for helping the consumer understand how he or she is doing in comparison to a specific investment goal – e.g., falling short of expectations, or exceeding them – and then to can adjust accordingly.

A note on the use of dollar-weighted methodology

The annual statement should include text to the effect that the timing of your investment decisions may lead to a discrepancies between your personal rate of return for a fund over a given time period and the average performance of that fund over that same time period.

Use of bolded text to highlight value of insurance benefits

We believe that the IVIC's annual statement should also state the value of the segregated fund's special features in prominent bolded text: e.g.,

On January 1, 2018, your variable insurance contract has a death benefit valued at \$75,569.23. If you, the policy holder died on date January 1, 2018, then 75% of the value of this contract would be guaranteed at that date, for a total value of \$75,569.23

The display of the dollar amount and percentage total of the assets guaranteed under a death benefit or maturity guarantee will help display the total overall value of the segregated fund to the consumer, so that he is reminded of the value and utility of what he has contracted for. The guarantees in an IVIC minimize the risk exposure in comparison to that of a comparable mutual fund, and help the advisor justify the fund's higher fees to the client during the annual review.

Styles and formatting of performance reporting

Figures Five to Eight set out a number of different ways that the variable insurance contract's features and benefits may be reported. With some minor modifications, the hypothetical forms are based on existing annual reports to IVIC policy holders. We would recommend extensive industry consultation and testing prior to the introduction of mandatory performance reporting requirements.

A complexity in applying CRM2-style reporting standards for IVICs arises from the fact that the insurance and investment aspects of the product are interlinked, in terms of the value on any given day of the insurance guarantees. Another consideration is the importance to the consumer – or the absence of importance – of the reporting of transaction details, whether routine ones or ones specifically requested by the client for a particular purpose, and of their impact on the value of the contract and its underlying funds. What level of granularity is sufficient? (It may be that clients should be able to select in advance the amount of detail they wish to receive in terms of the transactional details of their annual reports).

FIGURE FOUR. CRM2'S ANNUAL REPORT – REQUIREMENTS FOR MUTUAL FUND PERFORMANCE REPORTING.

CRM2 requires the annual reporting of the change in market value of the mutual fund holder's account, as well as personalized rates of return for 1, 3, 5, and 10-year periods, and since account opening.

With regard to the change in market value, this information is presented in Figure Four (see next page) in a bar graph format, which lets the client see the growth in value since the account was opened to the end of the current reporting period and the growth in value of the previous 12 months. As mandated by CRM2, this investment performance report provides the client with the definitions needed to understand the concepts of "market value" and "cumulative change in market value" since the account was opened.

Your investment performance report

For the period ending December 31, 2030

Investment account 123456789

Client name
 Address line 1
 Address line 2
 Address line 3

This report tells you how your account has performed to December 31, 2030. It can help you assess your progress toward meeting your investment goals. Speak to your representative if you have questions about this report. It is important that you tell your representative if your personal or financial circumstances have changed. Your representative can recommend adjustments to your investments to keep you on track to meeting your goals.

Total value summary

Your investments have increased by \$36,492.34 since you opened the account

Amount invested

means opening market value plus deposits including: the market value of all deposits and transfers of securities and cash into your account, not including interest or dividends reinvested.

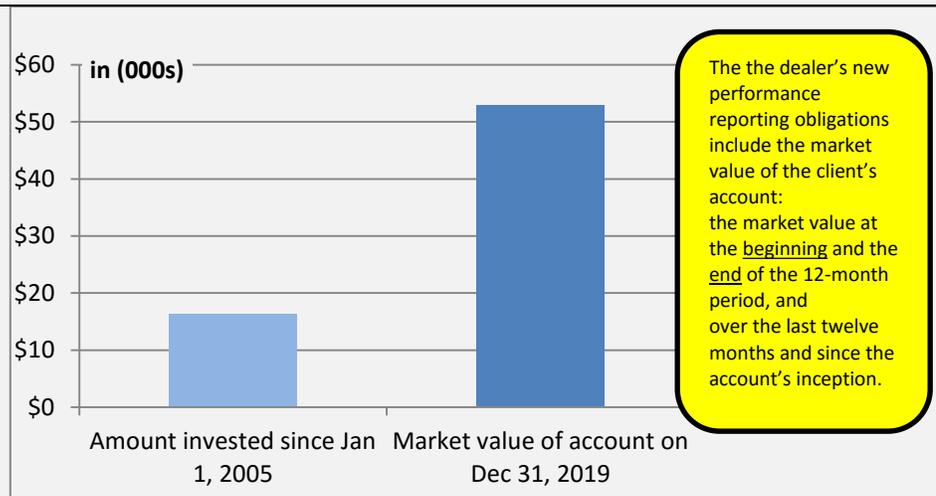
Your investments have increased by \$2,928.85 during the past year

Amount invested since you opened your account on January 1, 2005 **\$16,300.00**

Market value of your account on December 31, 2019 \$52,792.34

Less withdrawals

including: the market value of all withdrawals and transfers out of your account.



Change in the value of your account

This table is a summary of the activity in your account. It shows how the value of your account has changed based on the type of activity.

| | Past year | Since you opened your account |
|--|--------------|-------------------------------|
| Opening market value | \$51,063.49 | \$0.00 |
| Deposits | \$4,000.00 | \$21,500.00 |
| Withdrawals | \$(5,200.00) | \$(5,200.00) |
| Change in the market value of your account | \$2,928.85 | \$36,492.34 |
| Closing market value | \$52,792.34 | \$52,792.34 |

This CRM2 statement shows changes in market value and provides personalized rates of return for the 1, 3, 5, 10 year periods, and since contract opening rates of return.

Your personal rates of return

What is a total percentage return?

This represents gains and losses of an investment over a specified period of time, including realized and unrealized capital gains and losses plus income, expressed as a percentage.

For example, an annual total percentage return of 5% for the past three years means that the investment effectively grew by 5% a year in each of the three years.

The table below shows the total percentage return of your account for periods ending December 31, 2030. Returns are calculated after charges have been deducted. These include charges you pay for advice, transaction charges and account-related charges, but not income tax. Keep in mind your returns reflect the mix of investments and risk level of your account. When assessing your returns, consider your investment goals, the amount of risk you're comfortable with, and the value of the advice and services you receive.

| | Past year | Past 3 years | Past 5 years | Past 10 years | Since you opened your account |
|---------------------|-----------|--------------|--------------|---------------|-------------------------------|
| Your account | 5.51% | 10.92% | 12.07% | 12.90% | 13.09% |

Calculation method

We use a money weighted method to calculate rates of return. Contact your representative if you want more information about this calculation.

The returns in this table are your personal rates of return. Your returns are affected by changes in the value of the securities you have invested in, dividends and interest that they paid, and also deposits and withdrawals to and from your account.

If you have a personal financial plan, it will contain a target rate of return, which is the return required to achieve your investment objectives. By comparing the rates of return you actually achieved (shown in the table) with your target rate of return, you can see whether you are on track to meet your investment objectives.

Contact your advisor to discuss your rate of return and investment objectives.

In view of the Canadian Securities Administrator’s CRM2 template, the immediate task becomes one of determining which elements of it can and should be replicated in an annual report to the IVIC holder. Figures Five to Eight set out how the basic aspects of performance reporting relating to the notional units of a segregated fund held under a variable insurance contract, along with their impact on the value of the insurance guarantees, may be reported, in various degrees of detail, to the client on an annual basis.

FIGURES FIVE TO EIGHT: SEGREGATED FUND PERFORMANCE REPORTING.

Note: Figure Five is a composite of several currently used annual segregated fund annual reports. In certain sections, it also contains several of our reform proposals.

FIGURE FIVE: INVESTMENT PERFORMANCE REPORTING AND ITS RELATION TO THE MER AND INSURANCE FEATURES.

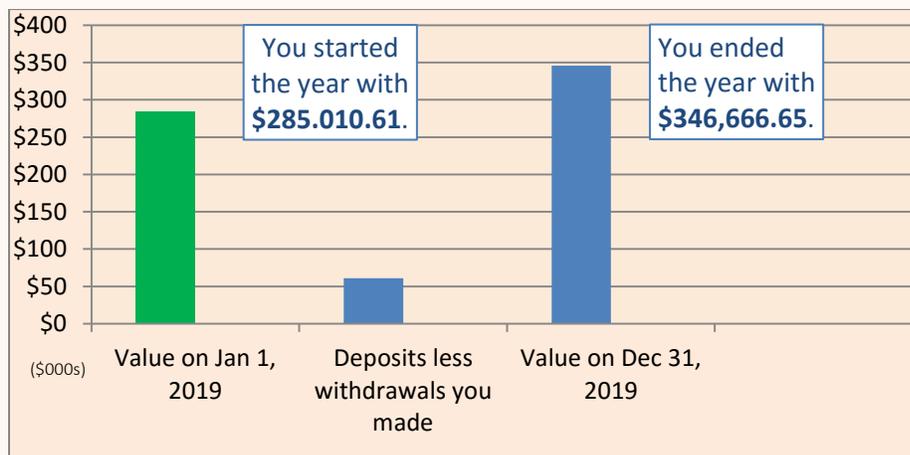
| | |
|---|---|
| SegFundCo | |
| Your investment performance report | |
| Investment account 123456789 | This report tells you how your account has performed to December 31, 2030. It can help you assess your progress toward meeting your investment goals. |
| Client name | |
| Address line 1 | Speak to your advisor if you have questions about this report. It is important that you tell your advisor if your personal or financial circumstances have changed. Your representative can recommend adjustments to your investments to keep you on track to meeting your goals. |
| Address line 2 | |
| Address line 3 | |
| Dear Mr. Doe, | |
| This report tells you how your investments have performed with us as of December 31, 2017, after costs have been deducted. This information will help you understand whether you are on track to meet your investment goals. | |
| Your segregated fund’s performance is affected by changes in the value of your investments, and deposits to and withdrawals from your account. | |
| Speak to your financial advisor if you have questions about this report. Be sure to tell your advisor if your personal or financial circumstances have changed. | |
| Performance of Investments and Fees | |
| A fund comparison to the industry average for similar investments can be found when you sign into your account at www.mysegfundco.ca . Go to the Accounts drop-down menu, then select Investment Performance. | |
| The fund management fees shown on your statement do not include the applicable sales tax. However, the sales tax is still charged to your account. | |

Management expenses include the operating expenses for both the segregated fund and the underlying funds. They also include the fees for the professional investment managers of the underlying funds. For more details about fees, go to the “Information You Should Know” section.

Annual change in value: here the annual change in value of all of the policy owner’s notional units in the contract’s segregated funds is calculated net of MER.

Your investment growth to Dec 31, 2019

Returns are after the MER has been deducted. It’s important to note that this doesn’t tell you how the fund will perform in the future. Also, your actual return will depend on the guarantee options you choose and on your personal tax situation. Please see the table below.



Investment Performance – Segregated Funds as of December 31, 2019

| Funds | 1 mth | 3 mths | 6 mths | YTD 1 | 1 yrs | 2 yrs | 3 yrs | 5 yrs | 10 yrs | Since Account opened | Inception Date |
|------------------------------|-------|--------|--------|-------|-------|-------|-------|-------|--------|----------------------|----------------|
| Canadian Equity Fund Class A | 1.1% | 3.4% - | 0.5% | 1.6% | 1.6% | 6.8% | 10.6% | 6.2% | 3.5% | 3.3% | 11/Oct/2005 |
| Elite Equity Fund Class B | 1.2% | 3.1% - | 0.2% | 4.9% | 8.9% | 13.2% | 8.1% | 4.1% | 4.8% | 9.8% | 1/Dec/1969 |

Reporting the 1, 3, 5, 10 and since fund inception rates of return: First, we would recommend that the content outlined in section 4.3 (c) of Guideline G2 become mandatory content for the consumer’s annual statement, as well as the rate of return since the fund’s inception. In addition, we would give companies the option to include performance data at the 1-, 3- and 6-month marks, as advisors and clients may find this information useful when considering certain options, such as a reset. As the IVIC holder ages, monitoring the performance and suitability of the contract’s segregated funds on a more regular or ongoing basis can be a useful activity.

This IVIC statement also provides personalized rates of return for the 1, 3, 5, 10 year periods, and since contract opening rates of return.

Your personal rate of return

The table below shows the total percentage return of your segregated fund for the periods ending December 31, 2020. Returns are calculated after charges have been deducted. These include charges you pay for advice, transaction charges and account-related charges, but not income tax.

| SEG FUNDS | Past year | Past 3 years | Past 5 years | Past 10 years | Since you opened your account |
|---------------------------|-----------|--------------|--------------|---------------|-------------------------------|
| Equity Fund Class A | 3.9 % | 4.9 % | 6.0 7% | 8.90% | 8.23 % |
| Elite Equity Fund Class B | 4.1 % | 5.3 % | 6.1 % | 8.3% | 6.01 % |
| Combined | 4.0 % | 5.1 % | 6.08 % | 8.47 % | 7.072 % |

Calculation method

We use a money-weighted method to calculate rates of return. Contact your representative if you want more information about this calculation.

Resets

Your SegFundCo Essential Series A offers you the ability to automatically "lock in" accrued capital gains in your variable insurance contract through a reset option. Resets are advantageous because they allow you to continually increase your guarantee amounts with minimal administration and cost to you. This lets you essentially lock in market growth from year to year, increasing the guaranteed amount when market value increases. The result is that you receive improved downside protection from your maturity and death benefit guarantees as they capture market upswings on an annual basis.

Once initiated, the automatic reset provides a new death guarantee that your beneficiaries will be assured to receive upon your death. Under your contract, resets occur each year on Dec. 28 up to and including the last year before turning age 70, when the resets stop. If on the reset date the market value is greater than the previous guarantee amount, it will be reset. If not, the previous guarantee amount remains intact.

Your Resets

Maturity guarantee

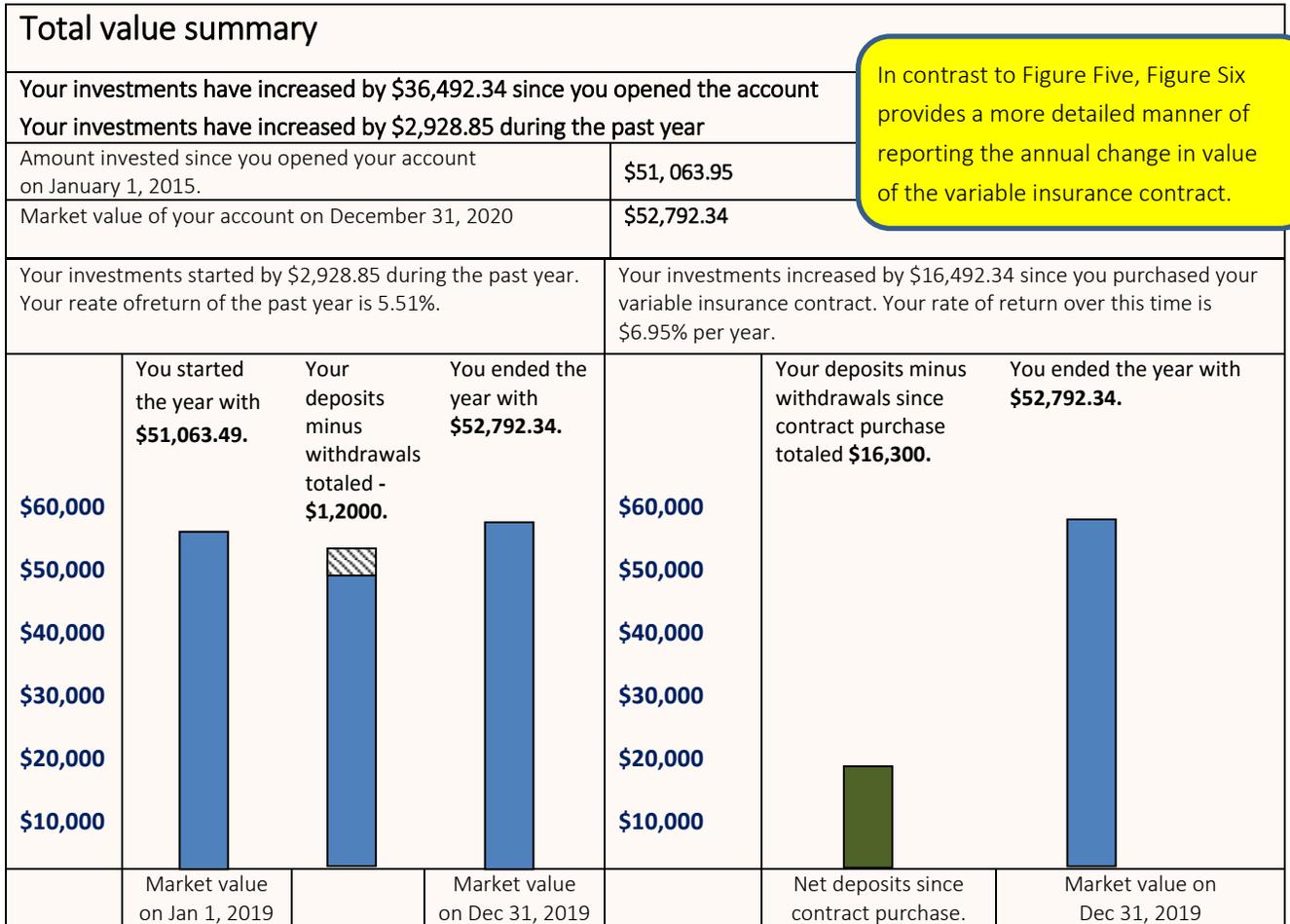
You received a maturity guarantee reset* on Dec. 28, 2019.

| | |
|------------------------------------|---------------|
| Maturity guarantee date | Dec. 28, 2028 |
| Previous maturity guarantee amount | \$199,999.99 |

| | |
|---|--------------|
| Current maturity guarantee amount after reset | \$259,999.99 |
| <p><i>* Resets occur each year on your policy anniversary date, December 28. The last reset will occur on the policy anniversary that is 15 years prior to the maturity guarantee date. When the maturity guarantee date is exactly 15 years from the fund entry date/policy anniversary, a reset may occur on the maturity guarantee date.</i></p> | |
| Death benefit guarantee | |
| You received a death benefit guarantee reset* on Dec. 28, 2019. | |
| Previous death benefit guarantee amount | \$199,999.99 |
| Current death benefit guarantee amount after reset | \$259,999.99 |

A. Reporting the Total Value Summary for the Segregated Fund.

FIGURE SIX: CHANGE IN TOTAL VALUE – SUMMARY DISCLOSURE .



B. Comprehensive Reporting the Change in Value of the Client’s IVIC – Includes Transaction Details.

FIGURE SEVEN.

Figure Seven shows how performance reporting can also be made in conjunction with transaction reporting.

| Change in the value of your account | | | | | | |
|--|--------------------------------|-------------------------------|--------------------------------------|-------------------------------------|---|--------------------|
| This table is a summary of the activity in your account. It shows how the value of your account has changed based on the type of activity. | | | | | | |
| | | Past year | Since you opened your account | | | |
| Opening market value | | \$51,063.49 | \$0.00 | | | |
| Deposits | | \$4,000.00 | \$21,500.00 | | | |
| Withdrawals | | \$(5,200.00) | \$(5,200.00) | | | |
| Change in the market value of your account | | \$2,928.85 | \$36,492.34 | | | |
| Closing market value | | \$52,792.34 | \$52,792.34 | | | |
| Transaction details from Jan 1, 2019 to Dec 30, 2019 | | | | | Transaction details are organized by fund to show all activity during the statement period. | |
| Fund name / Transaction date | Transaction description | Amount before deductions (\$) | Number of units transacted | X Number of units after transaction | Unit value (\$) | Market value(\$) |
| All Canadian Equity | | | | | | |
| Jan 1, 2019 | Opening balance | 000.00 | 100 | 10,000 | | \$19,999.99 |
| Mar 11, 2019 | Registered proceeds | 000.00 | 100 | 10,000 | | \$19,999.99 |
| April 30, 2019 | Cheque/cash premium | 000.00 | 100 | 10,000 | | \$19,999.99 |
| July 11, 2019 | Maturity guarantee top-up | 000.00 | 100 | 10,000 | | \$19,999.99 |
| Oct 28, 2019 | Death benefit guarantee top-up | 000.00 | 100 | 10,000 | | \$19,999.99 |
| Dec 31, 2019 | Closing balance | 000.00 | 100 | 10,000 | | \$19,999.99 |
| All Canadian Elite | | | | | | |
| Jan 1, 2019 | Opening balance | 000.00 | 100 | 10,000 | | \$18,999.99 |
| Jun 30, 2019 | Premium deposit | 000.00 | 100 | 10,000 | | \$18,999.99 |
| Dec 31, 2019 | Closing balance | 000.00 | 100 | 10,000 | | \$18,999.99 |

C. Summary Reporting of the Change in Value of the Client’s IVIC, with the Adjusted Value of the Insurance Guarantees

Figure Eight is based on an existing IVIC statement. It is relatively straightforward and provides a useful contrast to Figure Seven, which sets out the annual transaction details and their impact on the value of the contract. A complexity in applying CRM2-style reporting standards for IVICs arises from the fact that the insurance and investment aspects of the product are interlinked, in terms of the value on any given day of the insurance guarantees, on the value of future annuitized income, and of the importance to the consumer – or the absence of importance – of the reporting of transactional details, whether routine ones or ones specifically requested by the client for a particular purpose, and their impact on the value of the contract and its underlying funds. It may be that clients should be able to select in advance the amount of detail they wish to receive in terms of the transactional details of their annual reports.

FIGURE EIGHT: ANNUAL CHANGE IN VALUE AND THE VALUE OF INSURANCE BENEFITS.

Figure Eight shows the change in value of the contract’s notional units of segregated funds and related the current total investment value to the value of the insurance benefits. This hypothetical statement is much more of a “short form” effort at disclosure.

| | | |
|---|--------------------|--|
| How your ABC Segregated Funds are performing | | |
| What your investments were worth on January 1, 2017 | \$21,770.27 | Two important insurance protections <i>Your segregated fund investments in this contract come with a death benefit and a maturity benefit.</i> |
| Plus additional money you’ve invested | \$800.00 | |
| Less money you’ve withdrawn | \$0.00 | |
| Plus the change in value of your investments | \$709.15 | |
| Value on December 31, 2017 | \$22,479.42 | |
| Value of your Guarantees | | |
| | | One year ago your guarantees were valued as follows: |
| The current value of your Maturity Guarantee* is | \$22,779.42 | \$18,997.23 |
| <i>*Your maturity guarantee date is Dec. 28, 2018.</i> | | |
| The current value of your Death Benefit is | \$32,779.42 | \$27,976.34. |
| NOTE: The guarantees in an IVIC minimize the risk exposure in comparison to that of a mutual fund. This is the value of your assets not at risk owing to your insurance benefit at the time of the report. | | |
| As the policy holder of this segregated fund, if you died on the date DD/MM/YYYY, 75% of the assets would be guaranteed, for a total value of \$X,XXX.XX. | | |

Question 6. Are IVICs generally considered to be held as a long-term investment compared to other types of investment products?

Advocis’ Answer. IVICs are generally considered by advisors as suitable for clients to hold as long-term investment products; indeed, their chief use among Canadians is as a longer-term financial and estate planning tool.

Question 7. To what extent should the enhanced investment performance data requirements be harmonized with mutual fund rules?

Advocis’ Answer. As noted in our answer to Question 5, above, performance data should be enhanced so that the segregated funds’ performance metrics replicate those in the CRM annual performance statement.

Question 8. What additional data would be of value to IVIC contract holders?

Advocis’ Answer. As we note above, in terms of the insurance features of the IVIC, we recommend the inclusion of additional data – perhaps in the form of a text box on the annual statement – which show the value as of a particular date of several of the main features of the segregated fund. Again, this is so that the consumer can clearly see and understand the value of the insurance guarantees that come with an IVIC.

In addition, we would note the need for the consumer to consult with a qualified professional advisor regarding the tax treatment and possible tax consequences associated with an IVIC. This is because the tax treatment of segregated funds remains a source of confusion for many consumers. This is not surprising, given that the taxation of certain benefits available with annuity products continues to be somewhat unclear at the present time. We would suggest that when the CRA has issued clear guidance and developed uniform assessing practices in the area of the taxation of guarantee payouts or top-ups (maturity and death benefit guarantees), that the annual report contain information briefly explaining that:

The Canada Revenue Agency has now clarified the tax treatment and tax consequences associated with the insurance features, benefits and guarantees of your variable insurance contract. To learn more, and to learn if you are affected in any way, please consult with your advisor or a qualified tax professional.

Question 9. What differences could be made to take into account the guaranteed protections in an IVIC?

Advocis’ Answer. The guarantees in an IVIC minimize the risk exposure in comparison to that of a comparable mutual fund. We therefore propose to show the projected amount of assets at risk at certain times – in particular, the value of those assets that are fully or partially insured. Moreover, the IVIC’s annual statement should also state in prominent bolded text the current values of the segregated fund’s special features: e.g., “As of January 1, 2018, your contract has a death benefit valued at \$75,569.27.” This will help display the total overall value of the segregated fund, which will help consumers understand what they are paying for, and will help the advisor justify the value that is inherent in the segregated fund’s relatively higher fees to the client during the annual review.

Issue 4: Delivery of Fund Facts upon Subsequent Purchases

Question 10. Are there any reasons why segregated fund investors should not receive updated Fund Facts upon subsequent investment in the same fund? Please explain.

Advocis’ Answer. Our answer is no. At present, mutual funds require that if the *Fund Facts* document has been revised since the initial purchase of units in the fund, then a revised *Fund Facts* must be provided upon new purchases of units in the fund. Given the ease of electronic distribution and the overarching goal of reducing the disparity in disclosure outcomes for consumers between mutual funds and segregated funds, Advocis recommends that clients holding segregated funds be provided with updated Fund Facts according to the requirements which govern mutual funds. We believe that this requirement should be executed by the insurer.

Issue 5: Risk Classification Methodology in the Fund Facts Document

Question 11. What risk classification methodology do you believe is most appropriate for segregated funds and how should this be disclosed?

Background. Harmonization of two distinct product regimes

Currently mutual fund and segregated fund managers can select the classification method used to indicate the level of risk of the particular mutual fund or IVIC product. This presents fund manufacturers with opportunities to choose a method that may present a more favourable risk level than another method might indicate.

The CSA’s current project to implement a standardized risk classification methodology for Fund Facts promises to provide consumers with enhanced transparency and consistency, in order that they may

more easily compare investment risk levels in different mutual funds and exchange-traded funds. At present, the CSA proposes that the fund's risk level be determined at least annually, and be located in one of five categories, based on the degree to which returns varied over a 10-year period from the average return. If approved, the proposed amendments are expected to be in force in early 2017.

To what degree can the CSA's risk classification project be applied to segregated funds? Obviously, because of the guarantee in an IVIC, its risk exposure can be substantially different than that of a comparable mutual fund. That said, we believe that determining the appropriate risk classification methodology for segregated funds should be based on the principle of providing uniformity of disclosure – both in style and timing of reporting, as far as is practicable – to consumers in the mutual and segregated fund marketplaces.

The goal of harmonizing the two reporting regimes dictates that the CCIR adopt the CSA's proposed risk classification methodology for IVIC point of sale disclosure documents. Mandating the use of a consistent methodology will make Fund Facts a better document that will enhance its utility for consumers. By standardizing the information which the Fund Facts document conveys in regard to the riskiness of a mutual fund (expressed as a function of its historical volatility) the CSA will very likely enhance the document in a way that is consistent with how consumers typically use it: as a comparison tool between different mutual funds.

The limits of summary disclosure

While we commend both the CSA and the CLHIA for its position on Fund Facts does, it is just as important to be realistic about the document's inherent limitations: as a summary disclosure document, it is not and cannot be a mechanism for consumers to learn about and understand all of the material risks they need to know before making an investment decision. There are other major risks beyond volatility risk, such as counterparty risk and diversification risk, which are not necessarily expressed in the security's price. And the biggest risks for a particular consumer are a function of his or her personal goals and expectations in the context of an individual financial plan, and this can only be assessed by a qualified professional.

It is for these reasons that Advocis urged the CSA to ensure and promote a prominent role for professional financial advice. In the context of Fund Facts, this includes adding to the text on volatility risk a statement that the presentation of risk in Fund Facts is limited and recommending that consumers seek professional financial advice before making an investing decision.

Advocis' Answer. We believe that the CCIR should adopt the CSA's proposed risk classification model for segregated funds' Fund Facts. The Key Facts document could also address the limits inherent in any attempt to apply the CSA's mutual fund risk classification model to a segregated fund contract. The Fund

Facts should also explicitly state the benefit to the consumer in consulting with his advisor before any attempting to evaluate and gauge investment risk associated with his or her variable insurance contract:

Investment risks and segregated funds

Whenever you invest your money, you are putting it at risk. Segregated funds guarantee a minimum value on their maturity date, or upon your death. Consult your information folder for details of your guarantees. Please note that the guarantees don't protect you against market losses if you redeem before then. Investment risk is a complex phenomenon and the methodology used here has been selected for its utility in presenting risk assessments in a summary format and to be independently verified by third parties. **Be sure to consult with your financial advisor regarding the meaning and consequences of this segregated fund's risk rating.**

Issue Six: Oversight

Question 12. What should be the responsibilities of life insurance companies with respect to oversight of IVIC sales and their distribution? What factors affect the ability of life insurance companies to oversee IVIC sales?

Background. The position of advisors and managing general agents

With regard to the second part of Question 12 – what factors affect the ability of life insurance companies to oversee IVIC sales? – the main one is simply the regulatory and practical reality that segregated fund distribution is considerably different from that of mutual fund distribution. One issue is the relative remoteness of the dealing agent from the producer and distributor: often there is an intervening layer in the form of a managing general agent or brokerage, which is operating under contractual arrangements with the life company to act as an intermediary with independent agents. Another is the fact that a consumer cannot go the do-it-yourself route with an IVIC: he must purchase it from a licensed life agent in the jurisdiction in which he lives. Finally, life insurance companies all have their own particular forms of distribution networks, and depending on their jurisdiction of operation, a company will work under varying degrees of statutory responsibility for distribution of their products, including the sales conduct of their advisors. The role of the advisor can therefore be complex one: advisors may sell the products of more than one company, and if not tied to a single company may operate independently or be attached to a Managing General Agency (MGA), a national account, or a dealer.

The CCIR asserts (with no reference to documentary evidence) that complaint and enforcement data indicate that some life insurers *may not* be monitoring the product knowledge and sales practices of

those selling their products in a manner that is comparable to the monitoring conducted on the mutual funds sector. Moreover, the complaint and examination files surveyed by the CCIR indicate that in some cases life insurers have not accepted responsibility for the sales conduct of licensed intermediaries selling their products.

Insurers are best positioned to be responsible for oversight of advisors

Advocis believes that the insurer must bear the responsibility for oversight of the advisor. Indeed, they are the only party properly positioned to do so. First, there is the issue of structural dissimilarities in the oversight of distribution channels of mutual funds and segregated funds – in particular, the MFDA’s Tier 1 and Tier 2 supervision and registered Branch Manager requirements have no mandatory counterpart in the insurance sector. Second, MGAs do not have the regulatory ability to exercise direct oversight on advisors in the IVIC sales process. We would also note that they do not have the ability to exercise such direct oversight were it given to them without somehow being in receipt of the additional funding needed to cover the expense of such oversight. With regard to independent advisor, we understand it is tempting to argue that the MGA – given its proximity to the advisor in the distribution chain – should be responsible for ensuring that no conflicts of interest exist or that such conflicts are disclosed to the consumer. This argument ignores existing law, which holds the insurer responsible. More problematically, this argument would require a major legislative change, one which would dramatically restrict the ambit of the GA-advisor contracting process; a proposal that MGAs bear responsibility will only prove effective in practice if advisors are restricted to contracting with only one MGA (at least with regard to the distribution of segregated funds).

Advocis’ Answer. Our position is that the current set of responsibilities borne by life companies is, in general, the correct one. Insurers are the manufacturer and issuers of IVICs and, as such, properly bear the responsibility for:

1. The properly timed delivery of all mandatory disclosure related to the variable insurance contract and its underlying funds through the Information Folder, the IVIC contract, and ongoing reporting such as semi-annual and annual statements, trade confirmations and related documentation, and tax-related documentation; and
2. The supervision of the product’s distribution through advisor screening and needs-based sales practices: the insurer must determine the suitability of the advisor to act as its insurance agent through a process of assessment, which is set out in CLHIA Guideline G8, *Advisor Suitability: Screening, Monitoring and Reporting*, and the related *Advisor Screening Questionnaire*. The insurer then has to monitor the advisor on a continuing basis with regard to his or her compliance with statutory obligations and regulatory requirements, and with the insurer’s own policies on appropriate sales practice. CLHIA Guideline G2, *Individual Variable Insurance*

Contracts (IVICs) Relating to Segregated Funds, and in particular, the CLHIA Reference Document *IVIC Suitability Needs-Based Sales Practices* (February 2013) set out the needs-based approach to the sale of a segregated fund, with the latter providing "red flag" indicia to assist the insurer in its ongoing monitoring requirement. Using the indicia, the insurer should be able to identify situations which call for heightened monitoring, or potential instances of inappropriate sales practices which require investigation. Should the advisor trip one of these red flags, the insurer must then investigate to determine if the advisor has made a recommendation which is unsuitable in terms of the consumer's needs. If that in fact proves to be the case, then appropriate remedial steps must be taken.

In practical terms, we believe that the insurer is or *should* be required:

- on both a point-of-sale and ongoing basis, to compile, publish and ensure distribution of certain specified information about the IVIC and its underlying funds; critical aspect of this responsibility would be:
 - to ensure that the policyholder receives prior to or at the point-of-sale the most current version of both the IVIC annuity contract and the Information Folder (the insurer is responsible for the point-of-sale delivery obligations – for example, the insurer bears ultimate responsibility for the advisor's delivery of the Fund Facts and other elements of the Information Folder, and it is an unfair or deceptive practice for the insurer to not succeed in the Fund Facts' timely delivery);
- to ensure that the advisor who sells and, post-sale, advises on the segregated fund contract and the underlying funds, is properly licensed, trained, and supervised; and
- to properly partition and then delegate or otherwise ensure the effective management of the assets which represent the client's notional units in the segregated fund.

To conclude: at present the distribution of IVICs is subject to robust principles and standards. Accordingly, we do not believe that the existing responsibilities of life insurance companies with respect to oversight of IVIC sales and their distribution need to be modified in any significant way.

Question 13. What should be the responsibilities of intermediaries with respect to IVIC sales?

Advocis' Answer. With regard to the role of the advisor, we are largely supportive of the current regulatory regime in Ontario, in part because of the force of law given to CLHIA G2, *Individual Variable Insurance Contracts relating to Segregated Funds*.

The key elements of this regime are set out below, along with generally accepted industry best practices. We note the lack of uniformity across provinces with regard to obligatory continuing

education requirements and mandatory errors and omissions insurance is problematic in terms of implementing our proposals. This negatively affects the ability of Canadians to be assured that they are accessing professional quality advice in the IVICs sales process. The absence of *de minimus* standards in terms of ethics, education and other skills and competencies is problematic, and elsewhere we have argued forcefully for the introduction of a form of advisor oversight to a professional body – as was called for by the Ontario Auditor General in her 2014 annual report. Our own preferred model is in the form of a delegated administrative authority. What follows here, however, is a set of principles and requirements which we believe should be mandatory guidance for the regulation of IVICs.

Current and recommended responsibilities:

1. Unlike mutual funds, IVICs cannot be sold directly to consumers. Only an advisor licensed to sell life insurance by the province or territory in which the consumer lives may sell an IVIC.
2. The advisor must be contracted to sell the insurer's products. As a condition of licensing in Ontario, this individual is subject to market conduct regulations, required to maintain errors and omissions insurance, and earn ongoing CE credits. We believe that these requirements should apply wherever IVICs are sold in Canada.
3. The advisor should provide written disclosure about: (1) the insurer he represents; (2) any conflicts of interest; and (3) how he or she is compensated. The advisor should provide details of the trailing commission, including how it is calculated, and what services the consumer should expect in return.
4. The advisor should provide to the consumer mandatory disclosure regarding the IVIC before the sale. The advisor should use the Information Folder to help assist in consumer understanding of the key benefits or features of the variable insurance contract, the range of investment options available, and core information about the fund options, such as the type of fund, its past performance and risk profile, and its costs and fees. The advisor should also review the variable insurance contract with the consumer, especially those sections which set out the terms of the agreement between the consumer and the insurance company, and the consumer's rights regarding contract features such as future contributions, cash withdrawals, and guaranteed death benefit and maturity values.
5. The advisor should be qualified to help the consumer analyze and understand the IVIC in the context of his or her retirement planning, estate planning and overall insurance needs, and then offer recommendations suitable to meeting those needs. At the point of sale, the advisor should be able to assist the consumer in making appropriate initial decisions about the insurance guarantees, the selection of beneficiaries and joint annuitants, etc., and other available contract

options.

6. Beyond the point of sale, the advisor should be qualified to help the consumer by way of providing ongoing advice and services pursuant to the IVIC contract, such as making beneficiary changes, reviewing and updating investment strategies, and rebalancing the IVIC's investment selections if and as needed.

Fund Facts should emphasize the value of the advisor's role

Finally, we would note that any regulatory emphasis on written disclosure too often relegates to the sidelines the critical role of the advisor in the consumer's decision-making process. Comments made to regulators regarding IVICs, beginning with the Joint Forum in 1999, along with numerous academic studies on advice and advisors from various jurisdictions, have repeatedly indicated that savvy, experienced or more educated consumers have a much greater propensity to rely on advice from a trusted advisor than on a summary disclosure document alone (e.g., a two-page Fund Facts, a four-page Key Facts) or even a long-form disclosure document (e.g., a 70-odd-page IVIC contract or a mutual fund prospectus).

In other words, it is too often the case that those who need advice the most do not seek it out. There may be no more complex product purchased by so many mainstream Canadians which has as many moving parts as a segregated fund; no amount of summary disclosure can assist the typical retail financial consumer in fully understanding it. In large part this is because IVICs are long-term insurance contracts with a number of options in the form of investment-linked or capital-based variable features. These options are or can be directly connected to the major life events of the contract holder, such as his or her death. Given this complexity, it is critical that the consumer understand the significance of the information he or she receives. This is why the role of the advisor is so important in a segregated fund transaction. Accordingly, we emphasize the need for the Fund Facts document to state the following:

A segregated fund is a complex financial product. As the purchaser of this product, it is in your interest and your responsibility to consult with your advisor to ensure you understand your specific rights under the contract and how the contract's insurance and investment features fit with your financial goals, objectives, and overall personal situation.

Question 14. What could the industry do to address issues with insurer and intermediary supervision of the distribution and suitability assessment of IVICs?

Advocis' Answer. Our answer is essentially the same as that given to Question 13, above. However, we will note here several specific regulatory oversights or gaps which we believe should be remedied:

1. Lack of uniform requirements for advisors. The fact that in some jurisdictions sufficient errors and omissions insurance or the annual fulfilment of ongoing continuing education requirements are not mandatory must be addressed. The newly revised LLQP has a specific section on IVICs; it may be worth considering whether advisors selling IVICs should be required to periodically update their IVIC knowledge in terms of attaining a set number of IVIC-related continuing education credits in a prescribed time period (e.g. 2 credits every 3 years).
2. The special nature of insurance distribution. There is a special challenge involved in supervising segregated fund distribution, due to the presence of insurers, brokers, MGAs and agents, all of whom can complicate the lines of distribution and accountability. The presence of multiple intermediaries may lead to efforts by some insurers to attempt to transfer or download oversight responsibilities to other parties – the exemplary instance of which is the trend to attempt to place supervisory obligations on advisors with an MGA.
3. The absence of mutual fund-style supervisory apparatus in insurance distribution. Another complication factor is the absence in the insurance sector of the MFDA’s distribution requirements, which includes MFDA-registered Branch Managers and Tier 1/Tier 2 supervision, plus mandatory reviews of transactions, account openings, and annual KYC updates.

Address existing gaps in oversight and regulation with a Delegated Administrative Authority for advisors

Here we would note that Ontario’s recent Bill 157², *The Financial Advisor’s Act*, or Advocis’ proposed Delegated Administrative Authority (DAA) model, could assist in the professionalization of advisors and provide for enhanced standards of education and competencies. A DAA could be an effective way of ensuring compliance with a needs-analysis suitability approach for the sale of products such as segregated funds, and, post-sale, for the provision of suitable ongoing advice and service.³

Issue Seven: Standard of Care for IVICs, Including Updating Client Information

Question 15. To what standard of care should individuals who advise on and sell IVICs be held? Please explain.

Background. To understand IVIC sales oversight and the relevant standard of care, recourse must be

² Bill 157, *The Financial Advisors Act*, 2014, passed second reading in the Ontario Legislature and garnered all-party support before the Ontario government’s decision to call a provincial election. The text of the bill is online at http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=2934.

³ See our submission of September 21, 2015, to the Ontario Expert Committee on Financial Advisory and Planning Policy Options. Online at <http://www.advocis.ca/regulatory-affairs/RA-submissions/2015/Advocis-Submission-Expert-Committee-Sep15-with-Appendix.pdf>.

made to the local jurisdiction's *Insurance Act* and relevant regulations, as well as to a number of supporting guidance documents. These include:

- CLHIA Guideline *G8, Screening Agents for Suitability and Reporting Unsuitable Agents*, which sets out a framework to assist companies in establishing and maintaining a system for screening and monitoring agents;
- CHLIA Guideline *G18, Insurer-MGA Relationships*, which clarifies the roles, responsibilities and accountabilities within insurer-MGA relationships and provides advice for the MGA distribution channel;
- the CLHIA Document "The Approach," which sets out needs analysis criteria, as does FSCO's September 2014 *Life Insurance Product Suitability Report* – Appendix One of which sets out in flowchart form the process of ensuring suitability at the point-of-sale (composed with assistance from Advocis); and
- finally, CHLIA Guideline *G2, Individual Variable Insurance Contracts relating to Segregated Funds*, and, especially, CLHIA Reference Document *IVIC Suitability Needs-Based Sales Practices* (February 2013) which provides a fulsome discussion of the relevant suitability requirements for IVICs, as well as requirements in a number of important areas, including pre-sales disclosure, policy delivery, contracts, and fundamental changes.

Advocis' Answer. The standard of care: We are confident that the standard of care for IVIC sales should not be changed in any significant way. In addition, current CLHIA guidelines on managing conflicts of interest for life agents obviate any need to introduce a new requirement designed to deal with potential conflicts in the sale of segregated funds. The due standard of care should remain the current standard, administered as a form of principles-based regulation or PBR. A cardinal example of such PBR is found in the CCIR's three principles for managing actual or potential conflicts of interest:

- advisors must put the interests of policyholders and purchasers ahead of their own;
- consumers must receive disclosure of any actual or potential conflicts of interest associated with a transaction or recommendation; and
- recommended products must be the right fit and meet the needs of the consumer.

Simply put, advisors recommending segregated funds should ensure that the fund is appropriate to the needs of the client. This is to be accomplished pursuant to a needs-based assessment conducted by the advisor with the client and should be provided in writing to the client. The client should be under an obligation to provide to the advisor accurate financial and personal information in the needs-based process, and in the event of significant life events and financial changes. The advisor should explain to client the segregated fund's unique guarantee features and other benefits, plus its initial and ongoing

costs and fees.

A statute-based “best interest” duty or fiduciary duty

Finally, we see no need for the application of a statutory fiduciary or best interest standard in the sale of IVICs. When an advisor acts in a fiduciary capacity, the common law’s body of jurisprudence in the form of case law provides legal remedies. The push for introducing a statutory fiduciary duty is driven mainly by concern and frustration about recent or historical perceptions of failures to fulfill existing suitability requirements. In this respect, the CCIR Segregated Funds Working Group’s *Issues Paper* notes that:

. . . complaints about IVIC transactions showed that over 80% are related to agent sales practices, specifically around suitability of the product. Consumers typically complained that they had not understood features such as the lock-in period for guarantees or how fees/charges were calculated. Often, these clients had signed all required disclosure documentation, but this suggests that many do not read/understand them and perhaps would benefit from more proactive disclosure from the agents who sold them the products (emphasis added).

Without any way to determine what percentage of these complaints are valid ones, it strikes us as presumptive to decide that a fiduciary duty is the solution:

- the absence of a firm evidentiary basis should preclude such a drastic step;
- indeed, there is no reason to think that if regulators are not properly enforcing existing specific suitability requirements, that they will have any more success with the administration of a more wide-ranging statutory fiduciary duty;
- instead, as a possible first step in any reform effort, we should commit to achieving a better understanding the nature and parameters of the problem:
 - is it one of consumer education?
 - if so, would the administration of a consumer education quiz on IVICs at the pre-sale stage flag potential suitability pitfalls for the advisor and consumer?
 - is the problem an historical and ongoing failure of a small number of advisors to meet existing KYC and KYP requirements?

Until these questions and others like them are asked and answered, the CCIR should refrain from any onerous or intrusive steps to change the standard of care in this area.

Question 16. Should the “know your client” / “know your product” standards as used in the securities sector apply to the sale of IVICs?

Advocis’ Answer. Yes, in terms of the providing recommendations for the IVIC’s underlying investment funds. This would be the effort to discover and then document the client’s income and net worth, investment and planning objectives, and time horizon and risk tolerance. However, several caveats must be noted:

1. The IVIC is about investment *and* insurance: The MFDA’s KYC process in itself is not sufficient for an IVIC’s KYC process. The latter must also involve the estate planning elements of the insurance guarantees, and other options, such as annuitized income, that come with the variable insurance contract. This is where the CLHIA’s Reference Document *IVIC Suitability Needs-Based Sales Practices* provides a critical set of parameters for a needs-based suitability analysis.
2. The IVIC is inherently a less risky product: An MFDA-style KYC process would need to be modified in order to account for the long-term nature of the IVIC, and the impact on risk of the 75%/75% or 100%/100% insurance guarantees. For example, the use of a specific KYC checklist on risk tolerance could not be applied directly from the securities world, as the wording of the questions inappropriate to the specific risk and risk mitigation considerations which must be evaluated with an IVIC which is typically a lower risk product *vis-à-vis* mutual funds and other securities.
3. The IVIC KYC process should be principles-based: Finally, the product universe of the investment options available in a variable insurance contract is in general somewhat more restricted than that on the securities side, and presents the potential IVIC consumer with a slightly lesser degree of product complexity. This is major reason why the KYC for IVICs should be conducted with reference to the principles-based standards and documentation requirements set out in current CLHIA and FSCO guidance.

Finally, please see our answer to Question 17 for more on KYC requirements for IVICs.

Question 17. What requirements for updating client information should apply to IVICs intermediaries?

Background. Discussion of updating of KYC information

With regard to Question 17, the CCIR Segregated Funds Working Group’s *Issues Paper* notes that:

Client needs may change over time, and products that were once suitable may no longer be appropriate. This principle is well understood in the insurance sector. Mutual fund regulation is more explicit in requiring registrants to take reasonable steps to update information about their clients. A similar explicit requirement may be of value for IVIC contract holders.

In order to harmonize the disclosure regimes between segregated funds and mutual funds, Advocis believes that several MFDA rules should be adopted by segregated fund distributors. However, given the role of the IVIC as a long-term investment, we *generally* do not see any need for an IVIC holder's KYC information to be updated more often than that of a mutual fund owner.

Update in the event of material changes to client information: MFDA Policy 2 sets out specific guidelines which the dealer uses to establish the firm's policy handbook. Among other obligations, Policy 2 requires that a client's KYC information form be updated whenever the advisor becomes aware of a material change in client information. "Material change in client information" means "any information that results in changes to the stated risk tolerance, time horizon or investment objectives of the client or would have a significant impact on the net worth or income of the client." A client signature (or other internal control) which is sufficient for authenticating the client's identity and verifying his or her authorization must be used in regard to any change in client name, client address or client banking information.

Annual request for client notification of any significant changes to KYC information: Rule 2.2.4 (e) requires that MFDA Members must *at least annually and in writing* request the client to notify the dealer if there has been any material change in the previously provided client information or in the client's circumstances. The date of such request and the date upon which any such client information is received and recorded or amended must be retained.

Accordingly, we would suggest that a brief notice at the bottom of the IVIC's semi-annual statement would be useful in prompting the client to contact his advisor after the occurrence of a major life event, or of change in goals, circumstances and risk appetite. Finally, a brief form at the end of the annual statement could be used by the client to supply the advisor with updates on life events, goals and objectives, financial circumstances, and risk appetite.

Advocis' Answer. Advocis' position is that given the IVIC's guarantees, and its status as a long-term investment, we do not see any need for an IVIC holder's KYC information to be updated more often than that of a mutual fund owner. Accordingly, we believe that there should be an annual requirement that the advisor update client information, in order to ensure that he has sufficient information regarding the suitability requirements for an IVIC – as articulates in CLHIA Guideline *G2, Individual Variable Insurance Contracts relating to Segregated Funds* – in terms of:

- (i) the client’s investment needs and objectives;
- (ii) the client’s financial circumstances, including net worth and income; and
- (iii) the client’s time horizons and risk tolerance.

Client information should also be updated in the event of a material change to the variable insurance contract’s insurance features and options, or upon the client’s opening of a new account or contract.

As well, annual account statements for IVICs should contain a notification to the client advising him or her them to contact their insurer or advisor if their personal information has changed (e.g., occurrence of life events, and any changes to goals and objectives, financial circumstances, and risk appetite). This practice is currently undertaken by many mutual fund dealers to ensure timely updating of client information.

Question 18. In addition to the potential gaps discussed above, do you believe that there are other areas in which IVICs and mutual funds regulation may achieve a more harmonized outcome with respect to the fair treatment of customers? Please explain your response.

Advocis’ answer.

The Joint Forum of Financial Market Regulators was founded in 1999 by the CCIR, CSA and CAPSA, and immediately began considering many of the issues discussed above including, of course, point of sale disclosure for segregated funds. Since that time the ability to provide consumers with timely and accessible electronic disclosure has grown exponentially.

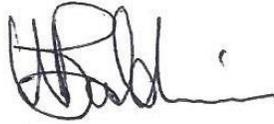
We believe that Canada’s financial retail services industry should consider if it is worth establishing an ongoing forum composed of industry stakeholder in both the insurance and funds sectors, including advisors, consumer and manufacturers/distributors, which would review disclosure issues and concerns.

Such a group could monitor industry trends and technological developments with an eye to providing regulators with advice and insight on how to better reconcile the mutual fund and IVIC disclosure regimes – particularly the document format and delivery requirements – as well as, more generally, examining the role for and limits of traditional paper-based disclosure and established and emerging forms of electronic disclosure. Advocis would be pleased to participate in or assist in the establishment or initiation of any such ongoing forum.

Advocis commends the CCIR for the work of its Segregated Funds Working Group. Should you have any questions, please do not hesitate to contact the undersigned, or Ed Skwarek, Vice President, Regulatory and Public Affairs at 416-342-9837 or eskwarek@advocis.ca.



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