

June 5, 2015

Expert Advisory Panel – FSCO/FST/DICO Mandate Reviews
Ontario Ministry of Finance
Financial Institutions Policy Branch (FIPB) &
Income Security & Pension Policy Division
Frost Building North, Room 424
95 Grosvenor Street, 4th Floor
Toronto, Ontario
M7A 1Z1

Fax: 416-325-1187

Email: FIPBmandatereview@ontario.ca

Re: Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario

Dear Sirs/Mesdames,

We are writing in response to the Ontario Ministry of Finance’s *Consultation Paper on the Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario*, published on April 21, 2015. The Government of Ontario has undertaken to review the role, structure and efficacy of all its agencies; as part of this process, the government has convened an Expert Panel to review the mandates of three agencies under the jurisdiction of the Ontario Minister of Finance: the Financial Services Commission of Ontario (FSCO), the Financial Services Tribunal (FST), and the Deposit Insurance Corporation of Ontario (DICO).

We are pleased to offer the following comments on the proposed review.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
PART ONE: ADVOCIS – WHO WE ARE	4
PART TWO: MANDATE REVIEW QUESTIONS	4
Questions 1 – 4: The Mandates of FSCO, FST and DICO.....	4
Question 5: Future of the Financial Services Sector.....	6
Question 6: Consumer Protection and Promoting a Strong Financial Services Sector	10
Question 7 - 9: Structural Models	11
Questions 10 - 11: Scope of Responsibility	18
Questions 12- 15: Corporate Governance.....	19
CONCLUSIONS AND LOOKING AHEAD	20

EXECUTIVE SUMMARY

Questions 1 – 4: The Mandates of FSCO, FST and DICO

The mandates of FSCO, DICO and the FST continue to be of direct relevance to the goals and priorities of Ontario. With regard to the execution of those mandates, Advocis believes that: (1) FSCO has served Ontario's insurance industry and its consumers very well over the years; (2) the relatively short period of time which has passed since the changes to the FST regarding the discipline of life agents makes it almost impossible to properly evaluate the efficacy of the FST *vis-à-vis* its amended mandate; and (3) DICO's mandate is being carried out effectively under conditions of limited funding and constrained budget resources.

Advocis believes that FSCO's mandate is in need of amendment – including a structural revision of the manner in which the various non-insurance-related responsibilities are carried out – and by whom. Some of the responsibilities currently under FSCO's purview should, we believe, be transferred to other regulatory bodies in order to better ensure clearer lines of regulatory accountability and realize efficiencies from the streamlining of the regulation of pensions, credit unions and co-operative corporations.

Question 5: Future of the Financial Services Sector

The financial services landscape in Ontario will continue to change at a rapid pace, and with an increase in consumer demand for ongoing innovation in financial services. In its *Consultation Paper*, the government anticipates that “structural changes in distribution channels, emerging new products, and increased competition are expected to significantly change how the financial services sector meets the future needs of consumers.” We agree. As the government itself suggests, “the mandates and functions of FSCO, the FST” and other agencies must be adapted to better address the “market transformation” which is expected to significantly alter the financial services sector “over the next 10 to 15 years.” The ongoing evolution of Ontario's financial services sector will therefore “impact... the ability of regulatory structures to effectively and efficiently protect consumers and respond to the needs of the sector.”

Accordingly, Advocis believes that there is a real risk that our current regulatory structures will not be adequate to the task of anticipating and meeting the future needs of Ontario's financial consumers. Now is therefore an opportune time to recognize that Ontario's financial services sector needs a new regulatory structure and improved accountability mechanisms. We believe that the Ontario government should adopt a modified “twin peaks” approach, one which borrows proven regulatory techniques and tools from the rest of Canada, by implementing a regulatory structure which harnesses as needed the most efficacious and useful regulatory structures and tools deployed by government departments, regulatory agencies, and government-recognized professional bodies.

Question 6: Consumer Protection and Promoting a Strong Financial Services Sector

Advocis believes Ontario needs a new approach to consumer protection, especially in light of ongoing changes in the design and distribution of financial products. Effective financial regulation should promote an environment receptive to established and new methods of raising capital, ensure the integrity of our financial markets, foster the confidence of retail investors in Ontario's capital markets, and in general promote better protection of Ontario's financial consumers – in particular retirees and pension plan members close to retirement.

At a minimum, retail investors and other consumers of financial products in Ontario need assurance that they have the ongoing ability to access affordable, professional-grade financial planning and product advice. The best way to ensure this access is to establish the provision of financial advice as a professional occupation in Ontario. And the

least intrusive or disruptive means to this end goal of professionalism is by way of the delegation of administrative authority to an organization to enforce professional standards and regulate the behaviour of financial advisors at all consumer touch points.

Question 7 - 9: Structural Models

With regard to the Consultation Paper's question "Are there any regulated financial services entities or sectors that would be suited to a self-regulatory regime?," Advocis would agree with the Auditor General of Ontario's *Annual Report 2014* and answer that FSCO should delegate certain tasks to a professional organization exclusively for financial advisors. This new organization should be a delegated administrative authority (DAA) for consumer-facing, individual financial service practitioners, such as life agents. This DAA would operate mainly by way of a principles-based approach, although the registration of individual financial advisors would be a rules-based matter for the DAA to conduct and enforce.

In our proposed regulatory structure, FSCO and the OSC would retain their formal independence from one another, and FSCO would retain many of the powers it currently uses to enforce the *Insurance Act* and to otherwise regulate the insurance-based market participants and stakeholders under its purview. However, the oversight of pensions would be transferred to a new Ontario Pensions Board. This structure could be operated for a pre-determined trial period, after which a mandatory legislative review of its effectiveness would begin. Allowing FSCO and the OSC to remain independent of one another would have the merit of preserving each agency's existing areas of regulatory experience and expertise, and minimize the disruption to firms, financial advisors and their clients, and to other stakeholders.

Questions 10 - 11: Scope of Responsibility

Advocis believes that prudential regulation and regulatory enforcement is not simply the function of a jurisdiction's regulatory architecture. It is as much a function of regulator's own culture, the level and effectiveness of inter-agency co-ordination, and each agency's own regulatory philosophy. With these principles in mind, Advocis believes that a number of traditional FSCO functions should be removed from FSCO's mandate, as follows: (1) the administration of the Pension Benefits Guarantee Fund and all other pension-related responsibilities should be transferred to a new Ontario pension regulator; (2) the incorporation, registration and oversight of co-operative corporations should be transferred to DICO; and (3) the remaining regulatory responsibilities FSCO has for credit unions should also be placed under DICO's auspices. Given DICO's performance record to date, it is appropriate in terms of regulatory functionality and efficiency to further consolidate under the auspices of DICO regulatory responsibilities for deposit insurance functions and related solvency concerns for credit unions, *caisses populaires*, and Ontario's co-operative corporations.

Questions 12- 15: Corporate Governance

Changes to governance structures of existing and potential future regulatory agencies must be done with an eye to the long-term health of the key sectors of Ontario's financial markets – insurance, securities markets, the pension system, and so on. A strong framework requires a clear mandate from policy makers to ensure that the regulator has the powers and the human resources to carry out good public policy. The commission structure of FSCO should be led by a clearer board-governed framework which comes with a rejuvenated insurance-focused mandate. There should be a separation of the Superintendent and CEO functions, both of whom should be members of the Board. Finally, there should be a clearer separation of governance of the FST from FSCO to improve independence and avoid perceived conflicts of interest in the area of advisor discipline.

PART ONE: 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 11,000 members, organized in 40 chapters across the country, are licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across Canada. Advocis members provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, and long-term care and critical illness insurance to millions of Canadian households and businesses.

As a voluntary organization, 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 put their clients' interests first. Across Canada, our members spend countless hours working one-on-one with individual Canadians on financial matters. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future. What follows reflects the priorities of Advocis' members and their clients.

PART TWO: MANDATE REVIEW QUESTIONS

Questions 1 – 4: The Mandates of FSCO, FST and DICO

- | |
|---|
| <p>1. <i>Whether, and to what extent, each agency's mandate continues to be relevant to Ontario's goals and priorities?</i></p> |
|---|

The mandates of FSCO, DICO and the FST continue to be of direct relevance to the goals and priorities of Ontario. To a large extent, much of the content of FSCO's mandate is at present more relevant than ever to Ontario's goals and priorities. But much has changed in the regulatory fields in which FSCO operates. Ontario no longer incorporates loan or trust corporations as a result of the reforms made a few years ago, and indeed it may be the case that in the near future the continuing decline in the number of Ontario-incorporated insurance companies will cause Ontario to remove itself from their solvency regulation. In contrast, in the last decade or so, Ontario has seen the growth of significantly larger, well-capitalized credit unions in the province, and so the role of DICO has become concomitantly more important. The recent reforms to the FST, including the expansion of its purview from the discipline of mortgage brokers to include that of life agents is a sign of its increasingly relevant mandate for Ontario's financial consumers.

- | |
|---|
| <p>2. <i>Whether the agency is carrying out the activities and operations as required in its mandate?</i></p> |
|---|

FSCO has served Ontario's insurance industry and its consumers very well over the years. The relatively short period of time which has passed since the changes to the FST regarding life agents

makes it almost impossible to evaluate the efficacy of the FST *vis-à-vis* life agents; we have set out our views on the matter in a submission to FSCO, *Modernizing Disciplinary Hearings for Insurance Agents and Adjusters* (September 30, 2013).¹ Finally, it would appear that DICO's mandate is being carried out effectively under conditions of limited funding and constrained budget resources.

3. *Whether all or part of the functions of the agency are best performed by the agency, or whether they might be better performed by a ministry, another agency or entity?*

Advocis believes that FSCO's mandate is in need of amendment – including a structural revision of the manner in which the various non-insurance-related responsibilities are carried out – and by whom. Some of the responsibilities currently under FSCO's purview should, we believe, be transferred to other regulatory bodies in the interests of ensuring clearer lines of regulatory accountability and sectoral efficiencies for pensions, credit unions, and so on. Some of FSCO's current responsibilities could be transferred to DICO, and others to a new provincial pensions regulator. As well, FSCO should have the ability – as called for in the Auditor General of Ontario's recent report – to delegate certain tasks to a self-regulatory organization for financial advisors. These revisions will be explored in more detail in the answers to Questions 5 and 8. As will be explained below, we do not believe that FSCO should see its responsibility for the regulation of individual variable insurance contracts, or other insurance products with an investment component, transferred to the Ontario Securities Commission (OSC).

4. *Whether changes to the current governance structure and associated accountability mechanisms are necessary to improve mandate alignment and/or accountability?*

Advocis believes that such changes are needed; indeed, the need for a realignment of accountabilities and responsibilities in the regulation of Ontario's financial markets is already overdue and will only become more pressing with the passage of time. These changes are explored in the answers to Questions 5 and 8, below. We would note here, though, that Ontario's aging population and the recent downturn in its aggregate accumulation of retirement savings (since the global financial crisis) is of special concern, and the establishment of a special, independent pensions regulator strikes us as a desirable reform. Concerns about retirement income adequacy among certain cohorts in the Ontario population, and concerns about longevity risk among the provincial population at large suggest the need for further development of regulatory expertise in the pensions sector, as well as attaining enhanced levels of financial literacy and ushering in a new approach to consumer protection, especially in the face of ongoing developments – which, initially at least, are often prompted by regulation – in the design and distribution of financial products. At a

¹ Online at <http://www.advocis.ca/regulatory-affairs/RA-submissions/2013/Modernizing-Disciplinary-Hearings-for-Insurance-Agents-and-Adjusters.pdf>.

minimum, retail investors and other consumers of financial products in Ontario need to be assured that they will have the ongoing ability to access affordable, professional-grade financial planning and product advice.

As we will explain in more detail below, the least intrusive way to accomplish this last goal is through Ontario establishing that the provision of retail- or consumer-level financial advice is a recognized professional activity. This would require the creation of a professional organization for financial advisors, the authority of which would be derived from the existing authority of a higher-level regulatory organization. The transfer of this authority would be by way of a legal mechanism known as “delegated administrative authority” (henceforth, this proposed organization will be referred to herein as a DAA). Depending on the particulars of its reporting and governance structure, such a DAA could be a way for the government to quickly address sudden and unforeseen regulatory concerns.

Question 5: Future of the Financial Services Sector

5. *What are your views on the future of the financial services sector over the next 10 to 15 years and how should the mandates and functions of FSCO, the FST, and DICO be adapted to address the market transformation to come?*

The financial services landscape in Ontario – due to Toronto’s prominence as a financial services centre – will continue to change at a rapid pace, and likely in a more intense and disruptive manner than will be experienced by most of the other provincial and territorial jurisdictions in Canada.² We will see an increase in consumer demand for innovation in financial services, and, with the passage of the global financial crisis, a return to more global competition from specialized financial institutions and capital markets.

The *Consultation Draft* rightly emphasizes these changes. It also correctly notes the importance of having effective financial regulation which promotes an environment receptive to established and new methods of raising capital, ensuring the integrity of our financial markets, fostering the confidence of retail investors in Ontario’s capital markets, and promoting better protection of Ontario’s financial consumers – in particular retirees and those retirement plan and pension plan members who are close to retirement. Finally, we would also add that the continuing importance of

² According to the City of Toronto website. “Toronto ranks 4th in the 2014 PwC *Cities of Opportunities Study*; 6th of 56 international financial centres in the 2014 Banker IFC rankings; and 11th of 82 cities in the 2015 Global Financial Centres Index (GFCI). The city also boasts one of the highest concentrations of financial services company headquarters in the world. Toronto is where global financial decisions are made. With more than 245,000 people working in the sector, the Toronto region is the 3rd largest in North America after New York and Chicago.” City of Toronto, “Key Industry Sectors – Financial Services,” May 26, 2015. Online at: <http://www1.toronto.ca/wps/portal/contentonly?vgnextoid=ea15c1b5c62ca310VgnVCM10000071d60f89RCRD&vgnextchannel=401132d0b6d1e310VgnVCM10000071d60f89RCRD>.

global capital to Ontario's capital markets means that one must assume that the risk of a foreign jurisdiction spreading a financial "contagion" to Canada – a risk that has somewhat abated in the contraction caused by the global financial crisis – will re-appear and continue to develop over time.

The need for rapid and flexible regulatory responses

All of this means that the ability of our regulatory structures to effectively and efficiently protect consumers and respond to the needs of the financial sector must be judged by how quickly they can respond to an unforeseen crisis, and how flexible they can address unanticipated consequences of changes in domestic and foreign markets and regulation. Bearing these needs in mind, we would therefore propose that the Ontario government consider the following observations and proposals when proposing changes to the mandates and functions of FSCO, the FST, and DICO.

The regulatory situation today

The current agency mandates of FSCO, DICO and the FST are not fully adequate to the task of protecting consumers. The *Consultation Paper* notes that "Consumer protection is a key goal of financial services regulation [and] is achieved by setting market conduct standards and regulating solvency. However, the current legislative mandates of FSCO, the FST, and DICO do not explicitly articulate that their goal is to provide consumer protection." Nor do the mandates of these agencies require "that consumer protection goals must be balanced against the goal of fostering a strong and innovative business environment."

In fact, the ongoing development of new financial products and distribution methods mean Ontario's financial consumers are already exposed to unnecessary levels of risk. We agree with the government's observation that "new technology, new service providers and new distribution channels have also increased options for consumers of all financial services, while supplementing traditional methods... there are concerns that the regulation of financial services products, or those who sell them, has not kept pace with these changes."

Finally, we must accept that the future needs of Ontario consumers – whatever they may turn out to be – almost certainly cannot be adequately met and addressed through our current regulatory structures. As for the future of Ontario's financial services sector, the government anticipates that "structural changes in distribution channels, emerging new products, and increased competition are expected to significantly change how the financial services sector meets the future needs of consumers." As the government itself seems to suggest, "the mandates and functions of FSCO, the FST" and other agencies must be adapted to better address the "market transformation" which is expected to significantly alter the financial services sector "over the next 10 to 15 years." The ongoing evolution of Ontario's financial services sector will therefore "impact... the ability of regulatory structures to effectively and efficiently protect consumers and respond to the needs of the sector."

Advocis’ proposal for realigning financial market regulation in Ontario

Advocis believes Ontario’s financial services sector needs a new regulatory structure and improved accountability mechanisms. In fact, now is the time to reconceive of how Ontario’s financial services sector is regulated, primarily by adopting a “twin peaks” approach (one modified to fit the peculiarities of Canada’s federal regulatory structure) which borrows proven regulatory techniques and tools from the rest of Canada by designing a regulatory structure which harnesses the unique aspects of government departments, regulatory agencies, and government-recognized professional bodies. Indeed, the *Consultation Paper* correctly observes that “across Canada, different jurisdictions have adopted different structural models for the regulation of financial services. Some jurisdictions have opted for an integrated regulator that is responsible for all sectors... Other jurisdictions deliver regulatory services through a combination of agencies, self-regulatory organizations, and government departments.”³

Advocis believes that the following redesign of Ontario’s financial markets regulation sets out core elements for any future comprehensive regulatory scheme. Ontario’s financial services sector would respond in a more timely, effective and efficient manner to the needs of Ontario’s consumers, businesses, and capital markets through the following realignments and redistributions of regulatory responsibility:

1) A realigned FSCO

Advocis believes that a number of traditional FSCO functions should be removed from FSCO’s mandate: the administration of the Pension Benefits Guarantee Fund and all other pension-related responsibilities should be transferred to a new Ontario pension regulator; the incorporation, registration and oversight of co-operative corporations should be transferred to DICO; and the regulation of credit unions should also be placed under DICO’s auspices. Finally, the commission structure of FSCO should be governed by a clearer board-governed framework. There should be a separation of the Superintendent and CEO functions, both of whom should be members the Board.

2) A realigned DICO

Advocis believes that the transfer of solvency responsibility to DICO in 2009 has worked well. We therefore believe that it is appropriate in terms of regulatory functionality and efficiency to further consolidate regulatory responsibility for deposit insurance functions away from FSCO to DICO. DICO should therefore continue to act as the liquidator for Ontario’s failed credit unions, and other related solvency concerns – and also assume regulatory responsibility for overseeing Ontario’s co-operative corporations, *caisses populaires*, and credit unions. It is in the interests of Ontarians to have a regulator develop a unique body of experience and expertise to carry on oversight of these “smaller-capital”

³ Ontario Ministry of Finance, *Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario: Consultation Paper*, April 21, 2015, p. 2. Online at <http://www.fin.gov.on.ca/en/consultations/fsco-dico/fsco-dico.html>.

corporate entities, which are best fostered under an approach somewhat different from that of the OSC.

3) A realigned FST

Advocis believes that there should be a clearer separation of governance of the FST from FSCO to improve independence and avoid perceived conflicts of interest. As well, the cross appointments of the FSCO Chair and Vice Chairs as the FST Chair and Vice Chair be eliminated and an independent board for the FST should be established.

4) A new Ontario pension regulator

FSCO is staffed by very capable and well intentioned professionals who do the best which can be expected with the resources available to them under their current mandate. However, FSCO lacks the proper mandate and sufficient resources to properly fulfill the role of being the province's pensions regulator. The Expert Panel has stated that it is "looking for fresh ideas on how to . . . provide efficient and effective regulatory oversight of pension plans to increase security for pension benefits."⁴ Advocis believes that the Ontario government should establish a separate pensions regulator and begin to implement a number of the recommendations made in the report from the Ontario Expert Commission on Pensions, *A Fine Balance – Safe Pensions, Affordable Plans and Fair Rules* (the *Arthurs Report*).⁵

The Auditor General of Ontario recently warned that FSCO does an inadequate job in protecting pension plan members. Indeed, the underfunding of Ontario based DB pension plans has deteriorated significantly over the past decade under the watchful eyes of the Ontario government's FSCO: the proportion of underfunded Ontario pension plans has increased from 74% to 92% while the total funding shortfall has increased from \$22 billion to \$75 billion.⁶ The Auditor General noted that "FSCO has limited powers to deal with administrators of severely underfunded pension plans... FSCO could use the powers it does have more effectively to protect plan members."⁷ The Auditor General also expressed uncertainty as to whether FSCO's "Pension Benefits Guarantee Fund, designed to protect members and beneficiaries of single-employer, defined-benefit pension plans in the event of employer insolvency, is itself sustainable."⁸ While the Auditor General recommended that FSCO be given powers similar to those of OSFI, the federal regulator, Advocis believes that now would be the appropriate time for Ontario to begin implementing the vision for the rationalization and reform of pension regulation set out in the *Arthurs Report*.

⁴ *Ibid.*, p. 11.

⁵ Ontario Expert Commission on Pensions, *A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules*. October 31, 2008. Online at <http://www.fin.gov.on.ca/en/consultations/pension/report/>.

⁶ Office of the Auditor General of Ontario, "Province Should Better Protect Pension Plan Members, Auditor General Says," December 9, 2014. Online at www.auditor.on.ca/en/news_en/14_newsreleases/2014news_3.03.pdf.

⁷ *Ibid.*

⁸ Office of the Auditor General of Ontario, *Annual Report 2014* (Office of the Auditor General of Ontario), p. 7.

In addition, in its 2014 *Ontario Economic Outlook and Fiscal Review*, the Ontario government announced a mandate review of FSCO that will consider, among other issues, the role of FSCO in regulating pensions. The budget indicated that the government intends to proceed with the development of regulations to implement the 2010 reforms to the *Pension Benefits Act* to modernize the powers of the Superintendent of Financial Services. As noted, Advocis would instead encourage Ontario to follow the recommendation of the *Arthurs Report* and replace FSCO with a new Ontario pension regulator to enforce Ontario's *Pensions Benefits Act*. This agency would need the ability to independently self-manage in a manner comparable to the OSC's. This agency would require the powers necessary to regulate the pension system and an annual budget sufficient to that mandate (which would include data collection and analysis, a robust risk management capability, the issuance of policy statements and opinion letters, the power to conduct hearings and to issue interim orders and advance rulings, as well as rule-making powers). A formalized arrangement would have to be enshrined in law regarding any relationship between this agency and both the FST and the Ontario Court of Justice regarding fines, penalties, orders, appeals, and other matters pertinent to the enforcement of and compliance with the *Pensions Benefits Act*.

Question 6: Consumer Protection and Promoting a Strong Financial Services Sector

6. *Should the legislated mandates of the agencies explicitly refer to the goal of consumer protection, and should that goal be balanced with the goal of promoting a strong financial services sector? If yes, how?*

Yes. Consumer protection is a key goal of financial services regulation. This goal is achieved by setting market conduct standards and regulating solvency. However, the current legislative mandates of FSCO, the FST, and DICO do not explicitly articulate that their goal is to provide consumer protection. At the same time, the mandates do not address that consumer protection goals must be balanced against the goal of fostering a strong and innovative business environment. Currently, only DICO, under the *Credit Unions and Caisses Populaires Act, 1994*, is required to promote and otherwise contribute to the stability of the sector it regulates with due regard to the sector's need to compete effectively by taking reasonable risks.

Advocis believes that Ontario should bring a strong, new approach to financial consumer protection. A major problem Ontario faces in its financial services sector is that existing law and regulation is almost exclusively product-focused. For example, the reduction of information asymmetries between financial services consumers, on the one hand, and financial institutions and their representatives, on the other, has been an ongoing reform goal of Canada's financial services regulators. The Fund Facts project is a singular instance of this form of regulation. However, the conduct of individual intermediaries, such as life agents, and other financial advisors, is not being

fully subjected to proper regulatory oversight that is informed by an understanding of consumer issues.

Accordingly, Advocis believes that the consumer protection functions which impact retail investors and other consumers of financial products and services would be best performed by a new entity, one which reports directly to the Ministry of Finance. This would be a DAA which is responsible for the behaviour of life agents and other financial advisors: in essence, the individuals from whom Ontario consumers purchase financial products, advice and other services. This DAA would supplement the current regulatory scheme by professionalizing the advisor-consumer relationship in the manner set out in Advocis' proposed *Raising the Professional Bar* model.⁹ By mandating that all financial advisors maintain membership in an accredited professional association, the DAA plugs current regulatory gaps by focusing on the standards which govern the consumer-advisor relationship. This DAA concept will be explored in more detail in the answer to Question 9, below.

Question 7 - 9: Structural Models

7. *Should FSCO continue to exist as an integrated regulator? If not, what model is more appropriate for the regulation of financial services in Ontario?*

Refocusing FSCO

Subject to the proposed reforms set out above, Advocis believes that FSCO should and must continue to exist as a regulator tasked with enforcing the various insurance laws and regulations of the province. To do this properly, FSCO needs to continue to operate with the degree of independence it has hitherto enjoyed. We would note that the Ontario government's *Consultation Paper* states that "Since the creation of FSCO, some have advocated a further integration of all financial services regulators into a single regulator."¹⁰ Moreover, as the paper goes on to say, "the financial services sector has been evolving rapidly, and the pace of change is expected to continue at an accelerated rate."¹¹ We see the second statement as a strong argument against the first statement: i.e., FSCO's tremendous experience and expertise in regulating insurance – which is unparalleled in Canada – should in fact be refocused through a streamlining of the agency's mandate and responsibilities.

How to address the classic case of regulatory arbitrage: segregated funds

Many industry stakeholders insist that the route to more effective consumer protection begins with the merger of FSCO and the OSC. Only the creation of a unified regulator can eliminate regulatory

⁹ Advocis, The Financial Advisors Association of Canada, *Raising the Professional Bar: Greater Consumer Protection Through Higher Professional Standards*, February 20, 2013. The proposal and related regulatory materials – including how the DAA model could be implemented – are available online at <http://www.advocis.ca/raisethebar/>.

¹⁰ Ontario Ministry of Finance, *Consultation Paper*, p. 11.

¹¹ *Ibid*, p. 10.

arbitrage. It is true that the retail investor is the loser in situations of regulatory arbitrage. Indeed, Advocis has long acknowledged that the considerable similarities between mutual funds and segregated funds mean that consumers often cannot differentiate one from the other, and unscrupulous individuals will bypass the OSC and Canadian Securities Administrators (CSA) initiatives designed to foster consumer protection in the purchase of mutual funds – such as the disclosure mandated by Phase Two of the Client Relationship Model (CRM2) – by selling CRM2-exempt segregated funds. The most effective, least expensive and least disruptive solution to regulatory arbitrage between insurance and securities products is not to merge the two regulators; rather, it is to require that FSCO’s mandate gives it a rule-making ability – in the realm of consumer protection – to require that insurers follow, as appropriate, securities-based disclosure requirements such as Fund Facts and CRM2. A DAA for financial advisors, including life agents, could be used to monitor and otherwise ensure that the disclosure on segregated funds and mutual funds is as harmonious as possible.

The perils of merging FSCO with the OSC: the demise of effective, efficient insurance regulation

In 2000, the government of the day proposed a merger of the OSC with FSCO. While this idea has since been shelved, its spectre remains. The regulatory expertise developed by FSCO working with industry stakeholders would very likely be swallowed up by the OSC, and principles-based regulation (PBR) of insurance would be replaced by a securities-style, rules-based approach which is not needed or even appropriate for the sale of the vast range of products and services offered by a licensed life agent to middle class Ontarians.

FSCO has been a knowledgeable and fair regulator, and Advocis and our members – speaking on behalf of their clients – would be opposed to a merger of FSCO with the OSC. Such a merger would see FSCO’s regulatory culture on insurance products and services disappear into the securities culture of the OSC. If a single regulator or system of regulation is allowed to dominate Ontario’s financial markets, FSCO’s existing regulatory expertise and proven regulatory approaches will disappear, with securities-based regulatory concepts replacing them.

The perils of merging FSCO with the OSC: Creating a monolithic, “too-big-to-fail” regulator

In addition to driving up the cost of even basic life products, such a merger would almost certainly see the status of FSCO as a body which enforces existing legislation replaced by an OSC-based approach, one in which the new OSC-FSCO hybrid would have decision-making, rule-making and adjudicative powers, similar to the current OSC.

In the absence of the type of structural reform we have set out above, current proponents of an OSC-FSCO merger would have the various subsectors of the province’s financial markets subjected to a “super-OSC” which would regulate life agents and insurance brokers, mortgage brokers, credit unions, and pension funds. This would mean that the future financial well-being of every Ontarian – even if he or she does not own a single security – would still be beholden to this super-regulator in a greater or lesser degree, provided he or she has a mortgage, owns a life insurance policy, holds car insurance, or uses a credit union.

But the demise of the four pillars need not necessitate the rise of a single super-regulator – and the resulting exposure to massive regulatory risk in the event the rule-making, rule-enforcing super-agency gets things wrong. Ensuring proper protection of the public interest and enhancing public confidence in the regulated sectors is best done on a sector-by-sector approach, one which recognizes and responds appropriately to the unique characteristics and challenges of each financial sector (pensions, credit unions, etc.). It is not done by subjecting virtually all of Ontario’s capital – including that of the province’s pension system and its massive exempt market – to a single entity.

8. *Should DICO continue to be a separate agency? If not, what model is more appropriate for the provision of deposit insurance and regulation of credit unions in Ontario?*

Yes. DICO should be the single regulatory agency for both deposit insurance and the activity of credit unions in Ontario. Credit unions and co-operative corporations are often very different from “mainstream” corporations, in part due to their activities and to their often smaller amounts of capitalization. This expansion of DICO’s mandate would also avoid the peril of a “too-big-to-fail” combined OSC-FSCO regulator, as described in the answer to Question 7, above.

9. *Are there any regulated financial services entities or sectors that would be suited to a self-regulatory regime?*

Yes. The regulation of financial advisors – in the case of this submission, those life agents who are currently governed by FSCO, could be delegated to a DAA. With respect to the delegation of oversight to a DAA by FSCO, the Auditor General’s report noted that

FSCO is responsible for directly overseeing more than 55,000 registrants and licensees in the insurance sector (this does not include insurance brokers, who are licensed by the Registered Insurance Brokers of Ontario) and more than 11,000 in the mortgage sector. *We felt that these large numbers could justify the industries assuming greater responsibility for overseeing their professions, including their establishing self-regulation and consumer protection funds, as is the case in many other similar self-regulated service industries . . . If responsibility for oversight of regulated financial sectors were to fall to associations that oversaw industries, FSCO could assume the role of overseeing those associations rather than overseeing individual companies. This would require that FSCO recommend changes to the legislation that governs these professions, but it would allow FSCO to focus its resources on more serious and strategic matters pertaining to the regulated industries.*¹² (emphasis added)

¹² Auditor General of Ontario, *Annual Report 2014*, pp. 151-152.

Recommendation 9 in Chapter 3, Section 3.03, of the Auditor General of Ontario's 2014 *Annual Report*, entitled *Financial Services Commission of Ontario—Pension Plan and Financial Service Regulatory Oversight* is as follows:

To ensure that regulatory processes exist commensurate with the size and maturity of the industries, the Financial Services Commission of Ontario (FSCO) should explore opportunities to transfer more responsibility for protecting the public interest and enhancing public confidence to new or established self-governing industry associations, with oversight by FSCO. Areas that could be transferred include licensing and registration, qualifications and continuing education, complaint handling and disciplinary activities. In addition, associations could be responsible for establishing industry-sponsored consumer protection funds to provide more confidence in their services by the public. FSCO should then submit such proposals to the Ministry of Finance for consideration of legislative changes that would make it possible. For regulated financial sectors, including insurance companies, credit unions and *caisses populaires* that have fewer registrants, FSCO, in conjunction with the Ministry of Finance, should explore the possibility of transferring its regulatory responsibilities to the federal Office of the Superintendent of Financial Institutions.¹³

Advocis' position on this recommendation now follows.

The new DAA and the goals of the present regulatory review

Financial sector regulation has three major policy goals, which are: (1) the preservation and promotion of financial stability; (2) the maximizing of aggregate levels of efficiency in the financial system understood either as a whole or in terms of its various component sectors; and (3) consumer protection. The policy goal of consumer protection is simpler and more concrete – it seeks to protect consumers, often understood as retail investors, from information asymmetries, and from exposure to undue or unnecessary levels of risk. In light of this, what would be the impact of the proposed new DAA for individual financial advisors?

DAA-based market conduct regulation and supervision

Securities and insurance regulation should, when focused on market conduct, seek to promote confidence in Ontario's financial system by ensuring the fair treatment of consumers of financial products and services; the promotion of financial literacy among Ontarians; the promotion of financial stability; a reduction in financial-based crime; and the preservation and promotion of the overall efficiency and integrity of Ontario's capital markets. Obviously much of what FSCO and the OSC currently do under their present mandates fulfills these goals.

However, financial services regulation should also protect consumers from the risks inherent in financial products and in financial services, while also establishing standards of conduct sufficient to

¹³ *Ibid.*, p. 153.

appropriate levels of consumer protection – and all without placing an undue regulatory burden on financial intermediaries. Otherwise, the regulatory costs will be passed onto those same consumers and result in a reduction in the consumption of essential financial services, such as professional financial advice. Certain reform measures will complement and improve current levels of consumer protection. Consumer protection regulation is, almost as a matter of necessity, outcomes based – which requires financial institutions, their dealing or advising representatives, and other intermediaries, to comply with both stringent rules-based regulation, as well as with more flexible principles-based regulation.

What Advocis has set out in its *Raising the Professional Bar* proposal is a professional DAA framework which focuses on the behaviour at the heart of the advisor-client relationship. It would afford protection to Ontario’s financial consumers on an *ex ante* basis by eliminating bad actors before they can cause consumer harm. And it would provide an opportunity to quickly address emerging regulatory concerns by having a PBR-based code of conduct which could be updated as needed to ensure regulatory action is taken in the immediate aftermath of the identification of a nascent regulatory problem. For example, consider the asset-backed commercial paper scandal – how far and how deep would the mis-selling actually have gone if suitability requirements were being adhered to? If, in order to sell asset-backed paper, one had to maintain membership in a DAA (with the power to audit its member advisors and suspend those engaged in mis-selling), it is hard to see how the ABCP fiasco could have gone as far as it did.

Reforming Ontario’s financial markets regulation

Microprudential regulation focuses on protecting individual components of the financial system – fundamentally, firms such as credit unions and banks, and financial markets – to ensure that they can efficiently perform their underlying economic functions. Macroprudential regulation seeks to protect the financial system’s ability to function as a network within which those individual components can efficiently operate; as such, it seeks to address and eliminate systemic risk.

Both these forms of regulation are being executed in Ontario with varying degrees of success by one or more of DICO, FSCO, and the OSC. DICO, for example, is a model of traditional financial regulation: its current mandate focuses on deposits and solvency because, historically, these issues have been the primary concern to arise as a result of the aggregation of individuals’ money – by taking deposits from customers and then allocating their money through loans – to borrowers to invest in productive projects, such as factories. So, from DICO’s perspective, much of its mandate is designed to ensure that Ontario’s deposit-taking entities continue to function efficiently. We have proposed changes to the mandates of DICO and FSCO to improve various aspects of microprudential regulation in Ontario.

Addressing imperfections in government regulation

Nevertheless, amending the mandates of existing agencies will only take us so far. Gaps will inevitably come to light in the province’s regulatory framework, regardless of how many reform projects are implemented. In this respect we would note that the Expert Panel has stated that it is

“looking for fresh ideas on how to. . . protect consumers of financial services. . . [and] maintain an appropriate balance between protecting consumers and promoting efficient markets.”¹⁴ It is to the development of such “fresh ideas” that we now turn.

The DAA model can reduce regulatory response waiting periods, ensure effective ongoing principles-based regulation, and protect consumers *before* harm occurs

A DAA for financial advisors would provide a level of *ex ante* consumer protection in terms of establishing requisite minimal standards of education and competence for advisors – a regulatory approach which is all but absent in Ontario when it comes to many of those individuals who hold out as financial advisors.

When it is introduced and put into force, financial regulation is of necessity tethered to the particular jurisdiction’s “financial architecture”—in our case, to the design and structure of Ontario’s financial markets, to its firms, and to its related institutional shareholders. To a very real extent, any particular piece of financial regulation is “frozen” at the time in which it is promulgated. Regulators try to get around this freeze by mandating in legislation reviews of the regulation on a periodic basis (say, every five years), and by relying on the more flexible approach permitted by principles-based regulation. But ongoing monitoring and updating of a piece of financial regulation can be costly, and is subject to political interference at each stage of mandatory periodic review. Similarly, principles-based regulation is open to the very natural human risk of embracing the *status quo*, even at a time when the *status quo* may need to be changed, however modestly. And of course much of the regulatory apparatus meant to deal with issues of market conduct operates on an *ex post*, after-the-fact basis.

The DAA model will allow for more timely and responsive regulation

Advocis believes that the creation of a DAA for financial advisors, e.g., one inclusive of life agents currently regulated by FSCO, and which reports directly to the Minister of Finance, could significantly reduce the time-lags experienced by regulators when implementing responses to emerging regulatory problems. While such time lags are inherent in formal microprudential regulation, our DAA proposal offers a means to provide for more timely policy responses to emerging issues in Ontario’s financial markets. The drivers of this enhanced time sensitivity find their basis in certain features of regulatory institutional design, particularly in regard to the fostering of appropriate incentives. Specifically, our DAA proposal would allow for more targeted and timely regulatory responses to concerns faced by Ontario’s financial consumers for the following reasons:

- (1) on a textual basis: the drafting, review and final promulgation of a piece of principles-based regulation which is to be followed by the members of the DAA can be more quickly achieved than the implementation of full-blown law and regulation (an example of this sort of textual regulatory supplement to an existing code is the *Guidance Notices* issued by the

¹⁴ Ontario Ministry of Finance, *Consultation Paper*, p. 2.

Mutual Fund Dealers Association of Canada (MFDA) pursuant to specific sections of the MFDA rule book);

(2) on a legal and political basis: if faced with events in Ontario's financial markets which clearly require curative or corrective direction, it is reasonable to expect that the Minister of Finance will exercise his discretionary powers as promptly as possible, given the minister's own sense of direct responsibility to voting Ontarians, and to his self-incentive to avoid the potentiality of political fall-out down the road, should it become apparent that the Ministry failed to take timely action when the problem was still in its nascent stages (e.g., consider how much more limited the damage from the asset-backed commercial paper scandal would have been in Ontario if the OSC's intervention on mis-selling to retail investors had occurred in a more timely manner); and

(3) in terms of institutional incentives: the DAA, in light of its reporting obligations to the Ministry of Finance, would seek to ensure that its members' observance of its own principles-based regulation (as set out, for example, in the DAA's annotated principles-based code of conduct) was at all times properly cognizant of the regulatory concerns which the regulator has identified as contemporary or emerging concerns requiring specific actions by advisors. If a DAA failed to ensure that its members are properly prudent and diligent in the management and execution of their regulatory responsibilities, then it could very well risk finding itself subject to ministerial intervention and review, particularly with regard to the interpretation and enforcement of its code of conduct. Such a DAA could even be at risk of losing its DAA status. These outcomes are strong incentives for the DAA to maintain a sufficiently robust level of consumer protection.

DAAs, to survive and flourish under the reform scheme we have set out both here and in our *Raising the Professional Bar* initiative, must have the support of a plurality of their members. But much more importantly, an advisor-based DAA, created by FSCO to specifically focus on the behaviours which emerge at the intersecting of the advisor and the client (whether it is a one-time sale or a relationship which lasts decades) must have the trust of Ontarians and their governmental representatives – in particular, that of the Minister of Finance.

A FSCO-delegated DAA: Setting standards to protect Ontario's financial consumers

It is difficult for Ontario's financial consumers to know if their financial advisor has achieved a standard level of proficiency. The development of practice standards, a code of conduct, minimum educational qualifications and continuing education standards, and specific licenses or designations for certain intermediaries (i.e., a CLU designation for those engaged in wills, estate planning and wealth management) are all consumer protection requirements which can be undertaken more effectively by a DAA than by a government agency.

Advocis believes that:

- the lack of legal protection for both title and scope of the term “financial advisor” confuses and misleads consumers in terms of services offered and standards of professionalism;
- the absence of a mandatory professional framework which clearly articulates for consumers the salient differences between financial planners, life agents, and other types of financial advisors, as well as other individual intermediaries who provide financial products and advice, should be addressed. This absence enables financial intermediaries to occasionally opt out of additional commitments to the detriment of their clients, especially if they find them too expensive or difficult to meet; and,
- the lack of a regulatory framework which will support professional bodies in a sector-wide regulatory structure, the absence of any direct policy measures which will support consumer access to affordable financial advice, and the absence of binding regulatory measures to support consumer access to effective forms of redress, all contribute to unnecessary levels of confusion and risk exposure on the part of Ontario’s financial consumers.

Advocis therefore supports the following regulatory reforms:

- the development and implementation of a modified “Twin Peaks” regulatory design, which recognizes and facilitates the role of a new approved professional DAA in assisting the Ontario Ministry of Finance and regulatory agencies in achieving their consumer protection and confidence mandates;
- the establishment of a public registry which is managed by the new DAA with a requirement for all financial advisors who sell product and/or provide personal advice to be individually registered; and
- the granting to the new DAA of powers of suspension regarding life agents suspected of material breaches of the DAA’s *Code of Ethics*.

Questions 10 - 11: Scope of Responsibility

10. What areas of responsibility could be removed from/or added to the mandates of FSCO or DICO?

The current mandate of DICO is to provide deposit insurance for depositors in credit unions, and to promote standards of sound business and financial practices for member credit unions. In fulfilling these responsibilities, DICO may examine the affairs of member credit unions. As we have stated earlier, FSCO’s current responsibilities for credit unions and *caisses populaires* should be transferred to DICO. In light of the recent increase in the complexity and size of Ontario’s credit unions, Advocis believes that now is the time for DICO to become the agency fully responsible for enforcing in the province’s credit union sector prudential policies, supervisory requirements, and the framework for market conduct. To do this effectively, DICO should look to the regulatory approach used by the Canadian Deposit Insurance Corporation for federally regulated financial institutions.

In Ontario, the Auditor General of Ontario's 2014 *Annual Review* recommended that FSCO improve the effectiveness of its regulatory oversight of co-operative corporations. We would suggest that this responsibility should also be transferred to DICO, to ensure that the unique aspects of the province's credit unions and co-operative corporations (often smaller-capitalized, and governed by less rigid rules) be allowed to continue to develop under the auspices of a regulator which would not be, *a priori*, be mandated to implement the more formal regulatory approach of a securities agency like the OSC.

11. *Should DICO continue to act as liquidator of failed credit unions?*

Yes. This is in keeping with the vision of an enlarged DICO set out in response to Question 5, above.

Questions 12- 15: Corporate Governance

12. *Is the commission structure of FSCO effective, or should consideration be given to establishing a clearer board-governed framework? Should there be a separation of the Superintendent and CEO functions? Should the Superintendent/CEO be a member of the Board?*

In light of the reforms to FSCO which we have proposed, we would suggest that the current commission structure of FSCO be retained and re-focused on insurance concerns. If an independent FST is put in place, there may be no reason to separate FSCO's Superintendent and CEO functions. It is important that the placing of insurance as FSCO's sole responsibility be given recognition through the appointment of commissioners familiar with the industry.

Accordingly, a committee which would canvass the province's insurance industry should be struck to determine how to better structure a revised FSCO, in order to better serve Ontario's financial consumers and other industry stakeholders. It is critically important that a new FSCO be able to conduct regulation by reliance on specialized senior commissioners who in turn are supported by a staff of expert senior managers. Along with the technical and administrative expertise demanded by the proper regulation of insurance, FSCO's own governance should be reflective of the importance of professional insurance advice in the financial planning of the province's citizens and indeed the crucial role the capital controlled by insurers can play in the province's financial future.

13. *Should there be a clearer separation of governance of the FST from FSCO to improve independence and avoid perceived conflicts of interest?*

Yes. Advocis supports the creation of an independent adjudicative tribunal.

14. Should the cross appointments of the FSCO Chair and Vice Chairs as the FST Chair and Vice Chair be removed and an independent board for the FST established?

Yes.

15. Is the board governed structure of DICO effective? If not, what alternate governance structure should be given consideration? Should the President/CEO of DICO be a member of the Board?

Given the reforms to DICO which we have proposed, the size of DICO's board should probably be increased, and the nomination process for DICO directors revised to better emphasize the relevant skills and expertise required to be an effective DICO board member.

CONCLUSIONS AND LOOKING AHEAD

Actual financial regulation tends to be imperfect. Like anyone else, the public and politicians – and even policymakers and regulators – are apt to be influenced by both popular and trade media, which can unwittingly paint a distorted portrait of a state of affairs by unduly emphasizing what journalists find interesting, understandable and accessible. In financial regulation, this distortion tends to become most manifest in the wake of a financial crisis; people naturally want to understand what happened, why it happened, and how to learn from it to prevent the next crisis. Regulators, post-crisis, often find themselves being expected to devote more resources than they would like to the concerns of the day (that is, to the crisis of yesterday), understandably may feel they are being buffeted by forces of political short-termism. The typical post-crisis outcome is therefore a focus on preventative regulation – and in particular regulation aimed at preventing the previous financial crisis from happening. But, on its own, this focus is always too narrow, because it is simply not possible for policymakers and regulators to always be able to see the causal elements of the next financial crisis coalescing on the horizon. It is for these reasons that we feel the Ontario government has shown tremendous foresight – and farsightedness – in its commitment to reviewing how financial advice is supplied to Ontarians, and by whom. We would urge the Ontario government to follow through on certain suggestions made by the province's Auditor General to delegate the responsibility for the actions of life agents to a professional membership organization, one which would be accredited as a professional DAA.

Any undertaking to reform the FSCO mandate should also be seen as an opportunity to address and alleviate current instances of inefficiency and unaccountability, as well as cases of unnecessary complexity or disproportionate levels of regulatory scrutiny. We have attempted to set out the parameters for a potential reform of the FSCO, FST, and DICO mandates in order to lead to the cultivation of ethical norms for financial advisors. The continued growth of interconnected financial markets, as well as the institutions that operate within them, all but guarantees that future crises which will require innovative regulatory responses will occur, and very likely with little warning.

Ontario's regulatory apparatus will need to be adaptable to the changing financial economic landscape.

The use of DAAs as a supplement to Ontario's conventional forms of regulation (which are being placed under considerable strain) will be an effective way of deterring socially undesirable behavior by individual financial services practitioners. Before Ontario firms begin to adopt the U.S.-style approach – recently exemplified by the actions of JPMorgan Chase, among others – to seeing regulatory fines less as an indication of misconduct to be avoided in the future and more as simply the cost of doing business, the self-regulation of life agents represents an opportunity to engender a culture of ethics within the financial services industry – one that would be pervasive in and amongst individuals, while also being embedded within financial firms, and yet insulated from the internal governance structures of those institutions. It is possible this form of self-regulation may eventually prove to be more effective than conventional regulation in the long term. But for it to succeed, the support of agencies which regulate macro-prudential level and those which enforce stringent rules-based norms of market conduct will be necessary.

Advocis would be pleased to offer further comment or assistance on this matter at any time in the future. To discuss any of the issues that we have raised, please contact the undersigned, or email Ed Skwarek at eskwarek@advocis.ca.

Sincerely,



Greg Pollock, M.Ed., LL.M., C.Dir., CFP
President and CEO



David Juvet, CFP, CLU, CH.F.C., CHS, FLMI, AMTC
Chair, National Board of Directors