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March 23, 2009

Mr. Jim Hall
Chair
Joint Forum Intermediary Regulation Committee
5160 Yonge Street
17th Floor, Box 85
North York, Ontario M2N 6L9

Dear Mr. Hall:

Intermediary Regulation Committee Consultation Session

Advocis, the Financial Advisors Association of Canada, would like to thank the Joint Forum for the opportunity to attend the Intermediary Regulation Committee Consultation Session on February 9, 2009. Advocis appreciates the opportunity to provide input as the Joint Forum considers the regulation of segregated funds and mutual funds with a view to harmonization of the regulatory regimes to ensure similar consumer protections to investors while reducing undue burdens or conflicts to industry participants. We believe that stakeholders and regulators, working together, can achieve far superior results for consumers and for the financial markets.

Advocis is the largest and oldest voluntary professional membership association of financial advisors and planners in Canada. Our members are provincially 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 are professional financial advisors who provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, long-term care and critical illness insurance to millions of Canadian households and businesses.

General Comments

Fundamental changes within the financial markets have highlighted the importance of cross-sectoral cooperation between financial services regulators, as identified problems simultaneously touch on insurance, pension and capital markets. We believe that the Joint Forum must focus scarce regulatory resources on cross-sectoral problems that pose real risks to consumers. At this time we are not aware of any such major problems.

The Joint Forum has made considerable progress within the last three years in dealing with cross-sectoral issues. This progress is attributable in large part to the adoption of a principles-based approach to dealing with issues.

The Joint Forum in 2005 released a document entitled *Principles and Practices for the Sale of Products and Services in the Financial Sector*. The purpose of this document was to set out best practices for the conduct of all financial intermediaries in their dealings with consumers of financial products and services, and to provide consumers with a benchmark to assess the conduct of any financial intermediary with whom they currently have a relationship, or are

considering establishing a relationship. Securities and insurance regulators across Canada unanimously endorsed this paper.

The eight principles and practices outlined by the Joint Forum in the paper are:

1. *Interests of the Client*
2. *Needs of the Client ("Know Your Client")*
3. *Professionalism*
4. *Confidentiality*
5. *Conflicts of Interest*
6. *Disclosure*
7. *Unfair Practices, and*
8. *Client Redress.*

In its backgrounder to the *Principles* document, the Joint Forum states its preference for voluntary principles that intermediaries would adopt. Therefore, it set out to identify principles and practices that industry associations and associations representing intermediaries would endorse on behalf of their members. The principles and practices are expressed as high-level principles rather than specific detailed requirements. The Joint Forum states that

> *"… a benefit of this approach is that they are general enough to dovetail with the existing codes of industry associations and voluntary codes can complement requirements set down by law and can be adapted to changing circumstances more quickly than a statutory code can. Once the principles and practices are widely adopted by industry associations, the Joint Forum is confident that they will come to be seen as the norm. Competition and market forces will operate to encourage higher standards to the benefit of consumers."*

We fully support this principles-based approach. However, our experience suggests that this approach has not been fully accepted by all regulators and most certainly not by the self regulatory organizations, namely the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC). On a going forward basis, we believe that the Joint Forum needs to ensure that all of its members and associated SROs are prepared to implement a principles-based approach.

We believe that the Joint Forum should ensure that principles-based regulation is employed in a consistent manner. We also believe that regulators should only exercise their regulatory powers in the case of identified market failures, information asymmetry, and consumer protection. In addition, regulators should undertake detailed consultation and analysis with market participants and SROs in order to clearly identify the "true nature of the problem", and should employ principles-based regulatory responses unless there is clear evidence that a more prescriptive approach is required.

We would like to commend the Intermediary Regulation Committee of the Joint Forum for consulting with many different stakeholders, including Advocis, in its current examination of the sale of mutual funds and IVICs. We understand that the Intermediary Regulation Committee is (i) examining the sale of mutual funds and segregated funds and obtaining further information on industry practices in order to assess whether financial services intermediaries are adopting the eight principles and practices in their dealings with consumers of financial products and services; and (ii) is examining whether there are any conflicts or undue burdens on financial services intermediaries who sell mutual funds and IVICs which may be minimized while promoting equivalent consumer protection. The Committee's process of information gathering from a number of stakeholders is extremely important.

This consultative process at the information gathering stage is extremely important since it is in the early stages of developing new policy directions where stakeholders input is the most valuable. We hope that all Canadian regulators will follow this example as a model for meaningful public consultation with consumers, financial advisors and other market participants. Similar approaches in the past, for example by the CCIR in managing conflicts of interest in the life and health insurance industry, have resulted in effective implementation of principles-based regulation.

We note that segregated funds are regulated by two different levels of government for different regulatory purposes: by federal legislation/regulation as it pertains to solvency and corporate governance of life companies, and by provincial legislation/regulation as it pertains to distribution and generally applicable elements of all life insurance contracts.

We are not aware of any major consumer problems in the sale and marketing of segregated funds. In our view, the current regulatory framework for segregated funds is appropriate and has resulted in a high degree of consumer protection.

While the two products share a number of similarities, they are distinct products from distinct financial sectors which require the application of the appropriate regulatory regime. The fundamental challenge in a project which may seek to harmonize the regulation of segregated funds and mutual funds is that regulators are dealing with two very distinct products and financial sectors. While derivatives have allowed insurance products to be structured as capital market products, and capital market products to be structured as insurance products, the convergence of regulation of the insurance and capital market sectors does not necessarily follow.

The regulatory objectives for segregated funds and mutual funds are similar, but given the differences in the nature of the products (including the underlying legal principles) the two products are regulated differently. In our view, given the fundamental differences in the products, harmonization of rules governing the two products is not practicable; however, the harmonization of outcomes (as reflected in the eight principles and practices set out above) is attainable and should be the desired goal.

Beside the guarantee of the principal component in segregated funds, there are significant differences from mutual funds which are attractive from a consumer's perspective. Some of the differences include:

1. Tax Planning: non-registered segregated funds are taxed at a preferred rate relative to mutual funds, and can benefit from personal tax credits.
2. Estate Planning: A preferred beneficiary designation is available in the segregated fund that allows for estate distribution outside the estate.
3. Asset Protection: All segregated funds including non-registered funds can be creditor-proof.

Given the differences between the products, applying the mutual fund regulatory regime to segregated funds may not benefit consumers.

Specific Comments in Response to Questions Set Out in Attachment A to the Consultation Letter Dated December 4, 2008:

The Joint Forum Intermediary Committee Consultation session looked at industry practices in a number of areas such as practice standards and licensing standards in order to assess whether any conflicts or undue burdens arise. Below are Advocis's responses to these key areas of examination.

1. **Compliance Monitoring:**
   How does internal compliance monitoring occur for intermediaries who sell IVICs and/or mutual funds? Please provide some examples of the systems your members have in place.

   Provincial regulations require insurers to establish and maintain a system that is reasonably designed to ensure that each agent complies with the Act, the regulations and the agent's licence including screening the agent for suitability to carry on the business as an agent (for example, see section 12 of Ont. Reg. 347/04). Insurance companies are required to monitor an agent's suitability and conduct as a licensee. Insurance companies ensure that financial advisors follow acceptable sales practices in such areas as replacement disclosure, conflict of interest disclosure and product suitability.

   Insurance companies monitor their intermediaries through spot audits using a risk-based approach.

   Mutual funds are sold through dealers who are members of the Mutual Fund Dealers Association (MFDA) and the Investment Industry Regulatory Association of Canada (IIROC.) These dealers have compliance officers, who monitor their firms' ongoing regulatory compliance, with particular regard to ensuring that Approved Persons and representatives of the dealer are complying with all relevant regulatory requirements.

   Regulatory compliance on the part of dealers that sell mutual funds, and their Approved Persons and representatives, also is monitored in the course of financial audits and sales practices audits conducted by staff of the MFDA and IIROC (collectively, the "SROs").

   Regulatory compliance also is monitored through compliance audits undertaken by provincial securities regulators, as well as by other regulatory bodies such as FINTRAC (with regard to anti-money laundering) and the CRTC (with regard to compliance with "Do Not Call" legislation.)

2. **Requirements to Obtain a License:**
   Are there any conflicts or undue burden resulting from differences in the requirements to obtain a licence to sell mutual funds and/or IVICs? (these differences could be differences across jurisdictions, as well as differences between insurance and securities sectors). Requirements include:
   a. **Proficiency requirements**
   b. **Experience requirements**
   c. **Sponsorship/supervisory requirements**
   d. **Insurance requirements**

   We are not aware of any conflicts or undue burdens resulting in the different requirements to obtain a licence to sell mutual funds and/or IVICs.

(a) Proficiency Requirements:

We believe that a high level of proficiency regarding the principles of investing can best be achieved through a professional platform for the delivery of financial advice, which encompasses professional designations, professional codes of conduct through best practice standards, meaningful continuing education and professional liability insurance. Many of these principles already are part of the regulatory regime that applies to life and health insurance licensees.

Individuals who want to be able to become a life insurance agent are required to complete and pass the LLQP. The LLQP proficiency standards have, as one of their 12 mandatory modules, "Fundamentals of Insurance Investments (Segregated Funds)" which has been reviewed and approved by regulators.

In addition, in Saskatchewan, for those financial advisors who do not have a LLQP, a person cannot act as an agent in the sale of segregated funds unless the licensee has passed an acceptable segregated fund course, for example, the Advocis Segregated Fund Course, approved by the Insurance Council of Saskatchewan.

In order to trade or deal in securities in respect of a Member of the MFDA, the Approved Person must successfully complete one of the following courses:

(i) the Canadian Securities Course offered by the Canadian Securities Institute;
(ii) the Canadian Investment Funds Course offered by the Investment Funds Institute of Canada;
(iii) the Investment Funds in Canada Course offered by the Institute of Canadian Bankers;
(iv) the Principles of Mutual Funds Course formerly offered by the Trust Companies Institute; or
(v) in the Province of Quebec, the courses entitled Placements des particuliers (CEGEP) and Cours sur les fond distincts et fonds communs de placement offered by the Canadian Securities Institute.

Branch Managers, Trading Partners, Directors, Officers and Compliance Officers are subject to further requirements (see 1.2.2 and 1.2.3 of the MFDA Rules for further details).

(b) Experience Requirements:

Some provinces (such as Ontario) do not require sponsorship once certain experience requirement levels are met (2 years) whereas others require an insurer to sponsor the agent for an indefinite period of time. Other provinces require the insurer to provide a certification in respect of the agent but do not require any exclusivity (such as British Columbia).

On the mutual fund side, upon commencement of trading or dealing in securities on behalf of a Member, the Approved Person has to complete a training program within 90 days and be supervised for a 6 month period (1.2.1(c) of the MFDA Rules and MFDA Policy No. 1 "New Registrant Training and Supervision" released December 11, 2008 (enclosed)).

(c) Sponsorship/Supervision Requirements:

As noted earlier, insurance companies are either required to sponsor an agent or provide a certification in respect of the applicant agent. In addition, as noted in Question 1, insurance companies are required to maintain a system to ensure that its agents comply with regulatory requirements and requirements as a licensee.

For mutual funds, MFDA Rule 1.2.1(c) provides that, upon commencement of trading or dealing in securities on behalf of a Member, an Approved Person has to be supervised for a 6 month period and the detailed requirements of such supervision are set out in MFDA Policy No. 1 "New Registrant Training and Supervision" dated December 11, 2008.

Each Member is required to appoint a compliance officer who is responsible for monitoring adherence by the Member to the By-laws, Rules and Policies of the MFDA (including

standards of business conduct under Rule 2) and securities legislation requirements. Members also have to have branch managers who ensure compliance with securities legislation, By-laws and Rules by their employees and agents, and who supervise the opening of new accounts and trading activity. Please see MFDA Policy #2 Minimum Standards for Account Supervision for details. According to a News Release dated August 26, 1998, the MFDA has also struck a Sales Practices and Compliance Committee which will, among other things, establish supervision rules.

(d) Insurance Requirements (Errors & Omissions Insurance):

Errors and omissions insurance is not required on the mutual fund side as a legislative requirement. In practice, mutual fund dealers require errors and omissions insurance as a contractual matter. The only legislative requirement is that Members (the corporate entity) have to take out insurance which includes fidelity insurance (insuring against the dishonest or fraudulent act of its employees or agents).

In order to sell life insurance (including segregated funds) each province (except PEI) requires errors and omissions insurance.

3. Continuing Education:
Are there any conflicts or undue burden resulting from differences in the continuing education requirements to maintain a license to sell mutual funds and IVICs?

Most provinces (except for the Atlantic Provinces) have certain continuing education requirements for life insurance licensees.

On the mutual fund side, MFDA Policy No. 2 “Minimum Standards for Account Supervision” states under the heading “Education” at paragraph 2 that introductory training and continuing education *should be* provided for all registered salespersons (my emphasis). In August 2008 the MFDA established a regulatory committee called the Proficiency and Continuing Education Committee to establish proficiency and continuing education requirements for salespeople, partners, directors, officers and branch managers of MFDA member firms.

Education about products is also obtained through insurers (manufacturers) and through MGAs who will sponsor continuing education programs. Advocis, through its forty-three Chapters and its four Schools, also disseminates knowledge regarding segregated fund products.

As noted above, Saskatchewan also requires that an approved segregated fund course (or the LLQP designation) be successfully completed prior to being able to act as an agent in the sale of segregated funds.

4, 5 and 6 Needs of the Client and Product Knowledge

Please describe the information collected to perform needs analysis by your members.

How do your members assess the effectiveness of the needs analysis in ensuring suitability of the investments in mutual funds and/or IVICs? Please provide examples of the systems that your members have in place.

Financial advisors conduct a client needs analysis before making any recommendations on particular products to consumers. This is an integral part of the client information-gathering

stage and confirmation of the client's goals and objectives. The financial planning process is a detailed comprehensive process involving a series of steps which include: identifying the client's goals and objectives; collecting information about the client's current situation; determining what their investment objectives are; their attitude toward risk and risk tolerance; their investment horizons (when they will need access to the funds, their plans for contributing to the investments and plans for withdrawals); how much portfolio volatility can be tolerated; performing an analysis to identify problems and opportunities; developing a financial strategy; making recommendations and an action plan checklist (which may include as an action item, for example, the need for a needs analysis to be done in the future to determine needs in the event of premature death).

The Industry Practices Review Committee (IPRC) of the Canadian Council of Insurance Regulators and the Canadian Insurance Services Regulatory Organizations in 2006 established the three key principles-based recommendations that they wished to see the industry address through harmonization of best practices:

1. priority of client's interest – an insurance intermediary (broker or agent) must place the interests of insurance policyholders and prospective purchasers ahead of his or her own interests;
2. disclosure of conflicts or potential conflicts of interests – consumers must receive disclosure of any actual or potential conflict of interest associated with a transaction or a recommendation; and
3. product suitability – the recommended product must be suitable to the needs of the consumer.

The IPRC stated that it expects brokers and agents will explain to their clients and document the reasons for recommending a particular product. The recommendation is based on the following:

- Fact finding appropriate to the circumstances, and assessment of the client's specific needs;
- A flexible needs assessment. The assessment should reflect factors including the underlying risk, the client's objective, and the complexity of the product being sold; and
- An agent or broker's product recommendation that meets the client's identified needs.

Product suitability is determined after a needs analysis has been conducted with the information provided and is often communicated through a written proposal, which will include an explanatory statement demonstrating an understanding of the need behind the product recommendation. The process, which will be documented in the client file, will include (but is not limited to):

- The initial assessment and evaluation
- The needs analysis
- Copies of an engagement agreement
- Product comparison information presented to the client
- Intermediary disclosure documents addressing conflicts of interest and
- Formal suitability statements/letters presented to the client.

When consumers are informed of the reasons why a particular product is recommended and the extent of any market searches done by the intermediary, they can decide how to proceed with the recommendation, for example, if further research is needed.

Advocis favours meaningful disclosure to consumers that is easily understood, relevant to the transaction, mitigates real or potential conflicts of interest and is easily comparable in a vast marketplace of life and health insurance products. In order to develop voluntary and consistent measures regarding intermediary disclosure, Advocis participated in the Intermediary Disclosure Working Group (along with the Canadian Life and Health Insurance Association (CLHIA) and other industry associations). The Working Group produced the "Advisor Disclosure Reference Document" in March 2005.

Advocis also developed its own Best Practices Guideline on Product Suitability along with an interactive web-based tool entitled "The Advocis Interactive Disclosure and Product Suitability Web Tool". This helps advisors to generate transaction and recommendation disclosure letters based on the Advisor Disclosure Reference Document, allowing them to customize letters for clients in all provincial jurisdictions, including Newfoundland's additional *Consumer Protection Document – Principles for the Sale of Insurance*. In the disclosure letter, agents disclose the companies they represent, any financial relationships they may have with those companies and whether an actual or potential conflict of interest exists. Newfoundland also requires insurance companies to include a document outlining the consumer's right to additional information and how to access it, with all newly issued policies.

Advocis also has worked with other industry participants, including the CLHIA, to standardize the needs-based sales practices that are integral to the product suitability principles, through the production of the reference document: *The Approach: Serving the Client Through Needs-Based Sales Practices.*

Advocis believes that the IPRC's principles-based approach to dealing with conflicts of interest, product suitability and client's needs, along with industry practices, are helping to ensure that the regulatory outcomes derived from the Joint Forum's "Principles and Practices for the Sale of Products and Services in the Financial Sector" are being met.

On the mutual fund side, advisors are required to ensure that each transaction is suitable, in keeping with clients' know-your-client ("KYC") information. This would include conducting a risk assessment to determine the level of risk a client may be exposed to in their investment choice. The MFDA has issued a Member Regulation Notice setting out its Suitability Guidelines in a Notice dated April 14, 2008.

How is appropriate product knowledge by your members selling mutual funds and/or IVICs ensured? Please provide examples of the systems that your members have in place.

Advocis and our members are committed to professionalism among financial advisors. Our members adhere to the Advocis professional code of conduct and enhance their competence and professionalism through utilizing the Best Practices Manual. In addition, through continuing education courses and programs sponsored by manufacturers or MGAs, financial advisors keep up to date about products that are available in the marketplace.

7. Legitimate Business

How is current information on IVICs and/or mutual fund clients maintained? How is the provision of advice ensured? Please provide examples of the systems that your members have in place.

Advocis has developed Best Practices Guidance and continuing education courses – "Loss Prevention" and "Uncomplicating Compliance" to ensure best practices are implemented by

advisors. Advocis' Best Practices Manual also deals at length with proper documentation. Advocis believes that it is important for advisors to maintain a written account of the process regarding suitability and know-your-client requirements in the client file. The documentation could include: information gathered from the client, the needs assessment analysis; copies of the engagement letter; product comparison information presented to the client; intermediary disclosure documents addressing conflicts of interest; and any formal suitability statements/letters presented to the client, which goes beyond a KYC document as is the case with MFDA requirements.

Various records must be kept in order to comply with Anti-Money Laundering (AML) legislation. Advocis worked extensively in cooperation with FINTRAC to develop course materials and best practices to implement AML guidelines.

In August 2007, Advocis released a guide to advisor obligations under the sweeping changes to the federal government's anti-money laundering and anti-terrorist financing regime. Advisors can also access a guide in the Advocis Best Practices Manual, as well as a continuing education eligible training module.

As of June 2008, all reporting entities (as defined under the AML legislation) are required to conduct an assessment of the money laundering and terrorist financing risks in the course of their business activities. This requires advisors to make a subjective assessment of whether a client represents a heightened risk, taking into account the type of customer, the type of product, the delivery channels, geographic location and other such key factors. A best practice for a risk assessment for an advisor's business is to perform it in two stages: Stage 1: business-based risk assessment of products, services, delivery channels and the geographic location business is conducted and Stage 2: clients and business relationships. FINTRAC Guideline 4 and checklists assist with the process. The advisor therefore assesses risks for money laundering and terrorist financing according to a combination of individual factors which have been identified for the advisor's specific business.

8. Conflicts and Undue Burden
Are there any other areas where conflict or undue burden exist resulting from differences in the regulation of intermediaries selling mutual funds and IVICs?

We are not aware of any undue burdens or conflicts arising from the differences in the regulation of intermediaries selling mutual funds and IVICs.

Conclusion:

We urge the Joint Forum to continue with its smart, principles-based approach to conduct involving financial intermediaries in their dealings with consumers of financial products and services.

The core regulatory principles that should guide the Joint Forum are:

- Act only in the case of market failures, information asymmetries or matters of consumer protection;
- Identify the problem through detailed consultation and analysis; and
- Employ principles-based regulatory responses unless there is clear evidence that, absent a prescriptive policy response, harm will be done to the market or consumers.

Regulation should be developed following detailed consultation with all relevant industry and individual participants in the capital markets at early stages. Whenever rules and regulations are

proposed, they should be supported by credible cost-benefit analysis and consideration of less burdensome alternatives.

Given the differences between segregated funds and mutual funds we believe that it is appropriate that the two products have two different regulatory regimes. Although there is some convergence in how the marketing and sale of these products is undertaken, given the differences between the products it is appropriate that the two products be regulated through different regulatory regimes.

Sincerely,

Greg Pollock
President and CEO

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Chair, National Board of Directors