IFIC
THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

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Delivered By Email : ccir-ccrra@fsco.gov.on.ca

CCIR Secretariat
5160 Yonge Street, Box 85
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Toronto, Ontario, M2N 6L9

Dear Sirs and Mesdames:

RE: Segregated Funds Working Group Issues Paper (May 16, 2016)

The Investment Funds Institute of Canada (IFIC) appreciates the opportunity to provide the following comments on the Segregated Funds Working Group Issues Paper, released on May 16, 2016 by the Canadian Council of Insurance Regulators (CCIR).

We commend the CCIR for its initiative to examine the regulatory frameworks for segregated funds/Individual Variable Insurance Contracts (IVICs) and mutual funds, and to identify potential differences in the regulation of these products that could be brought into alignment.

Basic understanding and objective of our comments

We agree with the paper's premise that IVICs and mutual funds are similar products and that reasonable harmonization between the two products would enhance the fair treatment of consumers. Taking this broader financial product approach would be consistent with a growing global trend toward harmonization.

Responses to CCIR Questions

Disclosure of charges and other compensation

The paper notes that disclosure of charges and compensation is not required for investments that are not securities, such as IVICs, although the Canadian Securities Administrators (CSA) and the Mutual Fund Dealers Association (MFDA) encourage dealers to voluntarily disclose them as part of the new CRM2 regime that now applies to mutual funds and other securities.

We support the disclosure-related recommendations [1] of the Canadian Life and Health Insurance Association (CLHIA), which include expanded CRM2-style statements for IVICs.

[1] Insurance Distribution in Canada: Promoting a customer focused system
http://clhia.uberflip.com/i/644367-insurance-distribution-in-canada

Alignment of MER reporting requirements will be particularly helpful for investors who deal with advisors who are dually licensed for investment funds and insurance.

Account performance

We also support providing IVIC investors with equivalent account performance reporting to that required of mutual funds under CMR2. For IVICs, the report would cover policy performance. Including this measure would assist IVIC investors to understand the nature of the product they have purchased and what they can expect it to deliver to them.

Product performance

We believe that Point of Sale disclosure measures are appropriately harmonized between IVICs and mutual funds.

Management Report of Fund Performance (MRFP) was adopted by securities regulators within National Instrument 81–106 to supplement the information in the financial statements by providing management assessment of the past performance and strategic position of a mutual fund. This information has proven valuable to regulators and fund analysts. However, before adopting similar and additional continuous disclosure requirements, the CCIR and CSA should evaluate their effectiveness for investors, and consider rationalizing the number of documents where it will reduce duplicate information delivery.

Disclosure upon subsequent fund purchases

Current point-of-sale disclosure regulations in the mutual funds sector are based on the premise that access to information does not equal delivery and, therefore, active delivery disclosure is required for materially changed information upon subsequent fund purchase. We recommend that CCIR/CSA undertake a joint project to modernize the delivery of information in a way that recognizes changing consumer preferences, behaviours, and use of technology. The evaluation should start with a re-evaluation of the effectiveness of current pre-sale delivery model for today's consumers.

Risk classification methodology

The CSA has proposed a standardized risk classification methodology for mutual funds and exchange-traded funds (ETFs) in an effort to provide enhanced transparency and consistency and to allow easier comparison of risk levels among different funds. IFIC fully supports the CSA's intention to mandate a standardized fund risk classification methodology for all funds.

Given the similarity of IVICs and mutual funds, there should be a standardized risk classification methodology adopted for IVICs similar to that to be adopted by mutual funds, with modifications to take into account the differences between mutual funds and IVICs, such as the risk impact of guarantee protections offered by IVICs.

Sales oversight

In the personal insurance sector, there are three broad categories of distribution:

1) Direct, exclusive agent—in this model the agent/advisor is directly contracted with the life insurer, and is only authorized to offer products approved by the life insurer;

2) Non-exclusive agent—the agent (whether incorporated or not) is not exclusive, and may offer all products made available by life insurers that the agent contracts with, and

3) Managing General Agent (MGA)—the agent (whether incorporated or not) is not exclusive but may offer all products made available through the MGA by way of its distribution contracts with the life insurers.

In the direct, exclusive channel, since the agent/advisor works exclusively and directly with the insurance company, the insurance company is ultimately responsible for the actions of the agent. As we understand it, insurance companies utilize a risk management procedure to perform targeted audits of advisor activities. In this channel, oversight of the advisor is direct and holistic and similar to the oversight of mutual fund advisors by their dealer firms.

In the non-exclusive agent and MGA channels, since the insurance advisor can work with a number of insurance companies or intermediaries, the supervision of the advisor as well as a holistic overview of a client's portfolio is separated and, therefore, more challenging to oversee. These distributed and multiple oversight arrangements present weaknesses in supervision that could negatively impact the fair treatment of consumers.

Applying the mutual fund dealer model to IVIC distribution would more clearly define where responsibility rests and whom to hold accountable.

Standard of care

<u>Training</u>

The CLHIA report referred to earlier in our letter also has, as its first recommendation, that "all jurisdictions establish continuing education criteria for life licensees." Continuing education for mutual fund advisors is also being considered by the MFDA. It is already required for both mutual fund and insurance advisors in Quebec through the Chambre de la sécurité financière. It is also a requirement for advisors in the Investment Industry Regulatory Organization of Canada (IIROC) channel. We urge both the insurance and mutual fund regulators to establish this requirement as it will ensure advisors' training is refreshed on a regular basis and enhance consumer confidence.

<u>KYC/KYP</u>

Based on our analysis, the needs assessments done in the insurance industry are fairly similar to the-know-your-client/know-your-product standards used in the mutual fund sector. However, CSA's Consultation Paper 33–404 seeks comments on proposals to enhance the obligations of advisors, dealers, and representatives toward their clients and proposes a number of targeted enhancements.

We recommend that the CCIR review the outcome of this consultation and adopt requirements, as appropriate, to keep the IVIC and mutual fund market conduct rules relatively consistent.

Additional issues not raised in the Issues Paper

Uniform application across Canada

We note that there is no guarantee that CCIR recommendations resulting from this consultation will be uniformly applied across Canada. This is quite different from the mutual fund regime where rules, once adopted, are generally applied consistently across all jurisdictions. CCIR members should commit to harmonized application of any new rules with the objective of ensuring IVIC consumers across the country enjoy consistent protection.

Improved cooperation between CCIR and CSA

Both the insurance and the securities industries have much to gain from a continued exchange of best practices. We encourage the CCIR and the CSA to establish a practice of regular information exchange as well as a shared objective of regulatory harmonization as each launches new initiatives. This would ensure consistent rule-making across similar products from the outset and avoid the creation of future regulatory gaps and inconsistencies.

Information sharing on sanctions

Under the current regime, dually licensed advisors who are sanctioned in one discipline can continue advising clients in the other discipline. An Ontario government 2014 auditor general report[2] on the Financial Services Commission of Ontario (FSCO) indicated that "[FSCO] did not have adequate procedures and information-sharing arrangements with other financial service regulators to ensure FSCO is notified immediately when agents are disciplined."

A recently published Advisor.ca investigation[3] identified nine cases between 2013 and 2015 where advisors were permanently banned by their respective securities self-regulatory organizations but remained authorized to sell life insurance products for periods ranging from six months to years after. Of those nine, six were still authorized to sell as of June 14, 2016.

Many securities dealers have also reported the lack of an effective automatic means of notification of sanctioned advisors. The absence of formal information sharing arrangements and sanctions protocols prevents the industry from taking urgent and concrete steps to protect investors from rogue agents.

We recommend that the CCIR, the CSA and its self-regulatory organizations put in place an information exchange protocol through which sanctions on advisors would be automatically communicated among regulators and with the industry. To help promote this culture of sharing disciplinary information, agents/advisors should, through the licensing process, be required to agree that, should they be sanctioned, such information can be shared with other financial services regulators and the industry.

[2] http://www.auditor.on.ca/en/content/annualreports/arreports/en14/303en14.pdf

[3] http://www.advisor.ca/news/industry-news/hidden-in-plain-sight-how-banned-iiroc-and-mfda-advisors-can-still-sell-insurance-207496?utm_source=EmailMarketing&utm_medium=email&utm_campaign=WIR_Newsletter

Next steps

This consultation has pointed to the need for appropriate harmonization across financial services rules to better serve investors and financial services clients. Collaboration across regulators should not be an occasional exercise but should be the norm. There are important structural aspects to consider that go beyond the scope of this paper and we urge the CCIR, in collaboration with other financial services regulators, to provide the opportunity for deliberate and open debate on these issues in order to achieve a fair and efficient system to better serve consumers. We will be happy to take part in any future consultations to achieve this objective. If you require further information, please do not hesitate to contact Kia Rassekh, Manager and Senior Policy Advisor—Quebec, at 514-985-7025 krassekh@ific.ca .

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Yours sincerely,

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THE INVESTMENT FUNDS INSTITUTE OF CANADA.