

Financial Institutions Division

Financial Sector Policy Branch

October 14, 2016

Department of Finance Canada

James Michael Flaherty Building

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Ottawa Ontario K1A 0G5

By email: legislative-review-examenlegislatif@canada.ca

Re: Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future – Response to the Invitation for Comments

Introduction

Harold Geller and MBC Professional Corporation are pleased to comment on the Department of Finance's consultation document entitled "Positioning Canada's Financial Sector for the Future". This consultation paper is a welcome step forward towards protecting Canadian retail investors and consumers covered by life insurance policies.

It is our submission that the Department of Finance can use the powers of the federal government to foster efficiency and confidence in both capital and life insurance markets with improved protection for retail investors and life insurance consumers.

General Comments

Decades ago, the federal government revised the so-called "Four Pillars", the historical silo structure of financial services regulation. Today, there remain regulatory silos of life insurance, securities trading and banking. Chartered banks have securities and life insurance arms. Life insurers have bank subsidiaries and relationships. The silo structure separating securities from life insurance is an outdated, but entrenched legacy at the provincial level. The federal government has approached regulation of the securities industry cautiously, seeking consensus from provincial governments.

While the constitutional legacy creates inefficiency and significant regulatory gaps, the federal government's constitutional powers provide significant ambit for regulation in the interest of all Canadian investors and consumers of life insurance. The federal powers in respect of "Peace, Order and Good Government" and "The Regulation of Trade and Commerce" can fill the gaps and provide overarching consumer protection.

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Our comments will be focused on the interest of Canadian consumers, including specifically, retail investors and consumers of life insurance (for simplicity “Investors” and “Insureds”). In particular, both chartered banks and life insurance companies are major players in these areas. Largely, consumer protection initiatives have been reluctantly accepted and drafted by these very banks and insurers from whom consumers require protection. As a result, the present protections are minimal and largely, without regard to the consumer’s interest. Within the scope of the federal constitutional powers, the federal government should step up its engagement to protect Canadian consumers who invest in securities and life insurance.

From the consumer’s perspective

- In many provinces, life insurers are largely self-regulating. They do not welcome or receive formal consumer input with respect to delivery of retail products and services; and
- Mutual fund and securities dealers are self-regulating and the self-regulation field is largely populated by industry with little role for or input from Canadian consumers.

In colloquial terms, from the consumer’s point of view, life insurers, mutual fund and securities dealers are the foxes who have been given charge of the hen-house.

The federal Financial Consumer Agency of Canada (the “FCAC”) is tasked with ensuring that federal financial entities comply with obligations to consumers. These entities include bank-owned insurers, securities and mutual fund dealers, and federally incorporated insurers, securities and mutual fund dealers.

In fact, this Agency takes little active role in setting and ensuring compliance with consumer related obligations. Its mandate should be informed by input from consumer advocates and empirical research. It should address the inequities that presently exist, particularly with respect to the gaps left by the provincial regulators and their creatures, the self-regulating national organizations. It is odd that the securities industry is self-regulated nationally by the Mutual Fund Dealers Association and Investment Industry Regulatory Organization of Canada, and quasi-regulated nationally by the Canadian Life and Health Insurance Association, but that these national institutions are regulated by provincial governments.

The policy context as framed in the discussion paper highlights Canada’s experience during 2008. Effectively, Canada’s financial industry fared well compared to that of many other countries. On the other hand, Canadian consumers’ experience was devastating. Many Canadians lost their retirement savings and their financial security. Much of this devastation could have been avoided if regulators addressed consumers’ interests. Much of this devastation could have been avoided in the sales arms of life insurers and securities dealers adopted a professional model as opposed to the present sales model. Simply put, the focus should be put on consumers not industry, as has recently been accepted in the U.S.

As observed in the discussion paper the environment in which Canadians interact with a financial institution is rapidly evolving. The life insurance and securities industry are driven by profit motives. This has diminished their role as trusted advisors. Today Canadian consumers have been left by regulators and the FCAC to a “buyer beware” environment. Customers have not been treated fairly. It is to be hoped that technology advances and consumer demand will eliminate commission-driven biases and the pursuit of profit at any cost to the consumer. That dream is a long way from reality.

While Canada may score highly on measures of financial inclusiveness, this means that most Canadians deal with financial institutions. These dealings, are often to the detriment of Canadians. Inclusiveness suggests the ugly side of utilities: monopoly, tied-selling and price-fixing. It is not a goal to be pursued without thorough regulatory protections.

Financial institutions now offer complex products to retail clients. This complexity has increased to the degree that few products are understandable by the average Canadian consumer. While the general concept of a product may be presented in a manner which a Canadian consumer may understand, the restrictions and risks are buried in complex legalese, if disclosed at all. As examples:

- What is a split share?
- Or an equity-linked note or GIC?
- Or a return-of-capital instrument?
- Or a 75% guaranteed segregated fund?

As a result, the Canadian consumer does not understand the product. Canadian consumer who is not clearly informed in plain language of the restriction and risks of these products cannot provide informed consent to the purchase of these products. Thus, most Canadian consumers should be viewed as “vulnerable consumers” and afforded significant consumer protections. To state the obvious, a life insurance contract or a mutual fund/securities prospectus are tools that favours the industry that drafts these documents using language which only sophisticated professionals understand. Even when the underlying services or products on offer could be suitable for the client, the wording used masks the risks and obligations.

The discussion paper properly notes the risk of fraud and financial abuse to Canadians. However, inappropriate sales of insurance and investment products present far greater risks to consumers. Losses from the sale of unsuitable arrangements is far more common, and often far greater in scope, than losses from fraud and abuse.

Demographic changes in Canada will increase the potential harm to Canadians from the culture of sales, as opposed to the culture of professionalism. Older Canadians will have less access to retirement pensions, and greater reliance on their savings (including RSPs). With the larger savings pools and increasingly complex financial products comes an increased reliance by Canadians on their advisors. The risk of loss of their savings by older generations is

unacceptable. Imagine a nation of Nortel pensioners. There is no point in having systemically sound institutions if the sales practices to Canadians, causes them to lose what the financial institutions have saved remain abusive and buyer beware driven. Without doubt, these are the greatest emerging risks faced by Canadians.

As the Department of Finance considers how to position Canada's financial sector for the future a major focus should be the Canadian consumer. Granted, a healthy financial sector is an important objective. So, too, is a healthy consumer sector. Both are stakeholders. The Department's policy objectives can encourage stability, efficiency and utility of the financial sector and the interests of the public, the consumer sector. The voices of industry will submit arguments about why market efficiency should be defined by the industry. In the face of sustained industry lobbying, the Canadian government should stand for the Canadian consumer. Without the Canadian government's active involvement, the Canadian consumer faces catastrophic personal consequences that are both foreseeable and avoidable.

In this submission, we urge the Canadian government to refocus the discussion away from the industry's interests and onto that of the Canadian consumer. The financial industry's success should flow from the success of individual Canadians aggregated into a whole. The social costs to Canadians of continuation of industry led so-called "consumer protections" must be reconsidered and costed.

There are excellent lessons to be learned from other jurisdictions, including Great Britain and Australia. Post-2008, U.S. reconsideration of consumer protection offers great lessons for the lagging Canadian experience. In Ontario, there has been substantial work by consumer advocates, including The Small Investor Protection Association and Kenmar. The Ontario Securities Commission's Investor Advisory Panel ("IAP") is the only formal ongoing consultation with securities regulators in the country. The IAP has commissioned empirical research and gathered extensive examples of how other jurisdictions have progressed from the high systemic risk that they faced prior to 2008 with a more modern and enlightened approach. Those other jurisdictions offer excellent lessons on how to decrease systemic risk to Canadians.

The discussion paper asks a series of questions on how to strengthen the financial sector framework and promote economic growth. These are worthy goals. Support innovation and competition while maintaining the stability of the system. The key to effective innovation and competition is to ensure that the consumer's interests lead that discussion. The financial industry is in conflict of interest when it proposes the base minimum standards for consumer protection. This should conflict end.

Consumer panels drawn from across Canada should be funded to conduct research and advocate on these issues. Regulators should consider the best practices for consumer protection from other jurisdictions. The international experience must be adapted to the constitutional division of powers in Canada, but who better to do this than the federal government with its leadership? This can best be done through requiring that all retail advisors

and dealers are without conflicts. They should be obliged to put the consumer's best interest first (as in the U.S. Department of Labor rule going into effect in 2017). They should be required to advise the Canadian consumer in plain language with disclosure of material risks and restrictions. The federal government should use all of its tools - including regulation of banks and federally incorporated insurance companies and securities dealers - to abide by consumer protection standards that require professionals to advise Canadians in their best interest.

It is greatly appreciated that the Department of Finance asks what other actions should be taken to ensure that the financial sector framework remains modern and technically sound. The federal government has a unique role in studying and proposing consumer protections to all Canadians and to their provincial counterparts. Where the constitutional division of powers limits the Canadian government's ability to protect all Canadians through regulation, it should encourage empirical research, consumer education, investor advocacy, and submit proposals of standards to the provinces. This would make an effective way to reset the Canadian financial system to be robust for future years.

We consent to the disclosure of this submission in whole.

Our personal identifiers may be disclosed upon publication.

Yours truly,

A handwritten signature in black ink, appearing to be 'H. Geller', written over a faint circular stamp or watermark.

MBC Professional Corporation and Harold Geller