



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

JULY 15, 2016

CCIR Secretariat
5160 Yonge Street, Box 85
17th Floor
Toronto, Ontario
M2N 6L9

Re: SEGREGATED FUNDS WORKING GROUP ISSUES PAPER

Dear Sirs/Mesdames:

The Mutual Fund Dealers Association of Canada (“MFDA”) thanks the Canadian Council of Insurance Regulators (“CCIR”) for this opportunity to provide our comments on the Segregated Funds Working Group Issues Paper. We support the objective of the Paper to identify existing and potential gaps in the regulatory framework for Individual Variable Insurance Contracts (“IVICs”) that need to be addressed in order to provide a consistent and harmonized level of investor protection across financial service sectors.

BACKGROUND

The MFDA is the national self-regulatory organization that oversees mutual fund dealers in Canada. MFDA Members are mutual fund dealers that are licensed with provincial securities regulatory authorities. MFDA Members administer approximately \$632 billion in assets and employ 83,000 Approved Persons (partners, directors, officers, compliance officers, branch managers, employees, and agents of the dealer who are subject to the jurisdiction of the MFDA). MFDA Members are responsible for managing a significant portion of the Canadian wealth management landscape, overseeing more than half of the over \$1 trillion mutual fund assets in Canada. MFDA Members primarily service mass market retail clients who represent approximately 80% of Canadian households.

As a general comment, we note that the trend toward financial product and service convergence, multiple licensing of financial service providers and a focus on the provision of financial advice and not just product sales necessitates a consistent and harmonized approach to regulating similar products and financial service providers. Many Approved Persons of MFDA Members are dually licensed as insurance agents and provide financial advice related to securities, insurance and other investment products such as Guaranteed Investment Certificates. The standard of conduct applicable to these individuals and the protection available to their clients should not be materially different based on what registration and regulatory framework the investment product is being sold, or the advice is being provided, under.

MFDA REGULATORY FRAMEWORK

The MFDA has an established regulatory framework with robust policy, compliance, and enforcement functions. The MFDA uses all of the tools within its regulatory framework of policy development, compliance and enforcement to educate, monitor and enforce standards of conduct. In order to provide context to our comments, we have provided an overview of the MFDA regulatory regime. While harmonization of rules and regulations governing similar financial products is a key component to ensuring a consistent level of investor protection, ongoing monitoring and enforcement of these rules is equally important to ensure harmonized outcomes for investors.

Policy

MFDA Rules set out detailed requirements for Members, including particulars respecting: business structures; capital requirements; insurance; books and records; client reporting, and business conduct. MFDA Rules are focused on key areas of investor protection and include suitability requirements, know-your-client (“KYC”) obligations, the requirement that conflicts of interest be resolved having regard to the best interests of clients, and the duty to deal fairly, honestly and in good faith with clients. MFDA Rules are supplemented by detailed guidance to assist Members and their Approved Persons in the interpretation, application of and compliance with MFDA By-laws and Rules.

Compliance

The MFDA is responsible for monitoring the compliance of its Member firms and their Approved Persons with its Rules and applicable provincial securities legislation. MFDA Sales Compliance staff performs regular on-site examinations of MFDA Member firms and Financial Compliance staff monitors Members’ financial filings and performs on-site financial examinations of Members. In addition to regular cycle compliance examinations, MFDA staff also conducts targeted examinations on specific risk areas and compliance sweeps. Monitoring of compliance by MFDA staff is also supplemented by education, training and assistance that staff provides to Members. During sales compliance examinations, MFDA staff review Member and Approved Person activity to identify inappropriate sales practices that may negatively impact clients, including the provision of unsuitable advice and transactions that result in clients paying excessive fees.

Enforcement

The MFDA enforces standards through the receipt and assessment of complaints, conducting investigations, and litigation of MFDA Rule breaches before MFDA Regional Council Hearing Panels. The Enforcement Department considers general and specific deterrence in its decision making. In all cases, the level of supervision by the Member of its Approved Persons will be part of the review. Cases are reviewed proactively, with a view to identifying possible associated misconduct and assessing root causes. The Enforcement Department works on a cooperative basis with other regulatory agencies and law enforcement organizations. The Enforcement Department also works on a cooperative basis with the MFDA Compliance and Policy Departments to refer cases and issues where appropriate.

HARMONIZATION OF REGULATORY FRAMEWORKS FOR SECURITIES AND INSURANCE

The MFDA recommends a harmonized and consistent regulatory approach and framework for IVICs and mutual funds which includes not only similar requirements with respect to the product but also consistent levels of regulation of intermediaries including: proactive onsite prudential and business conduct examinations of MGAs and their insurance agents, robust complaint handling and investigation procedures and procedures to follow up on insurance agents disciplined by the MFDA. In addition, fitness for registration standards should be harmonized with other insurance and securities regulators.

Having different standards for similar activities and the sale of similar products creates opportunities for regulatory arbitrage. In this regard, we note the concerns raised by the Ontario Auditor General's review of the Financial Services Commission of Ontario ("FSCO") and the recommendations of the Expert Panel appointed by the Ministry of Finance to review the mandates of FSCO, the Financial Services Tribunal and the Deposit Insurance Corporation of Ontario. The Auditor General noted concerns with respect to the current oversight regime for insurance agents in Ontario including insufficient proactive examination of insurance agents and the lack of reciprocal discipline and enforcement of agents disciplined by other regulatory authorities including the MFDA. The report of the Expert Panel issued in June 2016 included a recommendation that the mandate of the proposed new Financial Service Regulatory Authority ("FSRA") include an obligation to work and cooperate with other regulators (including self-regulatory organizations) to coordinate regulatory actions and avoid regulatory arbitrage and overlap. The Expert Panel also recommended that the FSRA adopt a regulatory framework and approach that would promote consistency across all regulated sectors. We support the recommendations of the Expert Panel and suggest that these recommendations be considered by the CCIR in its review of the regulatory framework for IVICs. As noted, a consistent and harmonized approach to regulating similar products and intermediaries on a national basis is necessary to ensure equal protection and treatment of customers.

EXISTING GAPS AND POTENTIAL GAPS IN REQUIREMENTS

Disclosure and Reporting Requirements

We support regulatory amendments to address the gaps identified in the Paper with respect to: disclosure and reporting of fees and compensation, charges and compensation reports, account performance, product performance and the adoption of a risk classification methodology for IVIC point of sale disclosure documents.

We note that concerns with respect to conflicts of interest, lack of transparency of fees and embedded commissions that resulted in the reforms under the Client Relationship Model Phase 2 ("CRM2") are also relevant to IVICs. Reporting under MFDA Rules and securities legislation is provided at the account level rather than the product level. Securities, segregated funds and other investments are commonly held in the same client account at MFDA Members. Under MFDA Rules, client account statements and performance reports must include prescribed information in respect of all securities and

other investment products transacted through, or transferred into, the Member. While disclosure of charges and compensation is not currently required for investments in the same accounts that are not securities such as IVICs, the MFDA has encouraged dealers to apply the same disclosure practices. Members are required to provide client disclosure where not all compensation received in respect of investments (i.e. securities and other investment products) has been included on the charges and compensation report. The MFDA may consider expanding disclosure requirements in the future to cover all products held in the client's account at the MFDA Member.

We support consistent reporting requirements for securities and IVICs to address the same concerns with respect to conflicts of interest, investors not fully understanding the fees that are being charged for the product, what the fees represent and the impact they have on investment returns.

Supervision, Suitability, KYC, Product Due Diligence and Standard of Conduct Requirements

In addition to reporting and disclosure requirements, there are other areas where standards for insurance intermediaries should be aligned with those for securities registrants. In particular, we would encourage harmonization of requirements with respect to supervision, suitability, KYC, product due diligence and standard of conduct.

A key component of the regulatory framework for mutual fund distribution is the supervision of Approved Persons by their dealer. MFDA Rules require Members to supervise the activities of their Approved Persons for compliance with MFDA requirements. In particular, MFDA Policy No. 2 (*Minimum Standards for Account Supervision*) imposes minimum standards for Member supervision of Approved Persons with regard to KYC and suitability requirements, which has resulted in a high degree of proactive control over advice giving. Members are expected to promote and enforce a culture of compliance to address all regulatory obligations. MFDA Rules require Members and Approved Persons to deal fairly, honestly and in good faith with clients, observe high standards of ethics and conduct in the transaction of business and not engage in any activity that is unbecoming or detrimental to the public interest. As noted in the Paper, life insurance companies retain varying degrees of statutory responsibility for distribution of their products across jurisdictions including the sales conduct of licensed intermediaries selling their products.

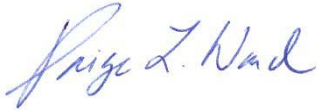
The MFDA has taken steps over the years to establish clear and objective standards and guidance regarding product due diligence, suitability standards, Member supervision and KYC requirements. In addition to MFDA Policy No. 2, the MFDA issued MFDA Staff Notice 0069 – *Suitability* which significantly changed the suitability framework from a general concept to clear and objective standards that have been operationalized by Members and Approved Persons and incorporated into their day-to-day advisory and supervisory practices. The MFDA has also focused on the collection of clear and complete KYC information by Members and their Approved Persons by requiring the use of detailed definitions of KYC terms so clients can understand how the criteria used relates to the advice they receive. In addition, Members and Approved Persons are subject to rules that require them to fully understand the products that are being

recommended to clients. Members must perform a reasonable level of due diligence on products prior to their approval for sale by Approved Persons and have written policies and procedures in place that describe in detail the steps to be followed in the due diligence process.

MFDA Members and their Approved Persons are subject to thorough and rigorous requirements with respect to supervision, suitability, KYC, product due diligence and standard of conduct. We encourage the CCIR to recommend similar standards to ensure effective oversight of insurance intermediaries and allow for equivalent fair treatment of customers under both regulatory regimes.

In closing, we recognize that there are differences between mutual funds and segregated funds. However, notwithstanding such differences, we are of the view that, to meaningfully close regulatory gaps and ensure the protection of investors across Canada, the regulatory frameworks for mutual funds and IVICs must be materially harmonized. We are concerned, based on our regulatory experience to date, and recent/forthcoming regulatory enhancements that have been made in respect of the securities industry, that to adopt any other approach will leave open and, increasingly, create new opportunities for regulatory arbitrage. We would be happy to meet with the CCIR to discuss in more detail gaps in the regulation of IVICs and mutual funds and how these could be addressed to ensure harmonization of investor outcomes.

Yours truly,

A handwritten signature in blue ink that reads "Paige L. Ward". The signature is written in a cursive style.

Paige L. Ward
General Counsel, Corporate Secretary & Vice-President, Policy

cc: Mark Gordon, President and Chief Executive Officer

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