Advocis
The Financial Advisors Association of Canada

February 23, 2023

Financial Services Regulatory Authority of Ontario
25 Sheppard Avenue West, Suite 100
Toronto, ON M2N 6S6

Dear Sirs/Mesdames,

Re: Consultation [2022-013]
Proposed Amendments to the UDAP Rule – Deferred Sales Charges

On behalf of Advocis, The Financial Advisors Association of Canada, we are pleased to provide our comments to FSRA in response to the Consultation on Proposed Amendments to the Unfair or Deceptive Acts or Practices ("UDAP") Rule – Deferred Sales Charges (the "Consultation").

1. ABOUT ADVOCIS

Advocis is the association of choice for financial advisors and planners. With over 17,000 member-clients across the country, we are the definitive voice of the profession. Advocis champions professionalism, consumer protection, and the value of financial advice. We advocate for an environment where all Canadians have access to the professional advice they need.

Advocis members advise consumers on wealth management; risk management; estate, retirement and tax planning; employee benefits; and life, accident and sickness, critical illness and disability insurance. In doing so, Advocis members help consumers make sound financial decisions, ultimately leading to greater financial stability and independence. In all that they do, our members are driven by Advocis' motto: *non solis nobis* – not for ourselves alone.

2. COMMENTS

We thank FSRA for its ongoing efforts to better protect the public. Our members share FSRA's goal of ensuring a fair and efficient financial services marketplace for all.

Like FSRA, we know that segregated funds provide unique benefits to consumers. The segregated fund guarantees reduce the risk exposure in comparison to comparable mutual funds. In addition, as an insurance contract, segregated funds also provide estate planning and creditor protection benefits.

As FSRA implements the deferred sales charge ("DSC") ban, we urge regulators to ensure both consumer protection and continued access to segregated funds. FSRA must permit a viable business model for financial advice and segregated fund sales for all market segments, not simply those at the upper end of the wealth distribution.

We recognize that the time of the DSC has come and gone. We urge FSRA to implement the DSC ban in a manner that is simple, transparent, and cost-efficient.

In our response to this Paper, we discuss the key features of segregated funds and the importance of continued access to these products. We also urge FSRA to adopt a simplified approach to the elimination of segregated fund DSCs.

The Benefits of Segregated Funds

Segregated funds are an important investment and insurance product. They provide Canadians with long-term financial stability and efficient estate planning. Their insurance guarantees reduce risk compared to a similar mutual fund. In addition, as a life insurance contract, segregated funds can pay out directly to the beneficiaries, without passing through probate.

The Canadian public values ready access to segregated funds. Market research indicates that more than 80% of consumers are satisfied that segregated funds provide reliable retirement income, protection against risk, and reasonable returns.[1] Regulatory reforms must ensure that Canadian investors—particularly small investors—continue to have access to these valuable products.

Segregated funds are underpinned by an insurance contract that reaches maturity after a long period. Segregated funds are meant to be bought and held. Investors recognize this. Data from the Canadian Life and Health Insurance Association (CLHIA), indicates that the average hold period for a segregated fund is nearly 8 years.[2] Investors hold segregated funds for the long-term to reap the full benefits of the insurance guarantees.

Since a segregated fund is a long-term investment, consumers need to carefully consider the benefits and costs at the time of initial sale. Consumers need high-quality advice from their advisor when they consider whether to invest in a segregated fund. As a result, advisors incur significant costs early in the life of the contract, as they assess the suitability of the product and provide advice to their clients. Advisors must be paid for the advice that they provide.

[1] On behalf of the Canadian Life and Health Insurance Association (CLHIA), Abacus Data interviewed 709 people who had experience with segregated funds and 782 who had experience with mutual funds between September 4 and October 3, 2022. "Data to Advocis – CCIR Upfront Commissions for Segregated funds," CLHIA Discussion Paper, October 28, 2022.

[2] "Data to Advocis – CCIR Upfront Commissions for Segregated funds," CLHIA Discussion Paper, October 28, 2022. This is significantly longer than the average hold period for a mutual fund of only 4.5 years (see: "Quantitative Analysis of Investor Behavior, 2020," DALBAR, Inc. www.dalbar.com).

With the elimination of DSCs, regulators must ensure that they do not inadvertently remove access to segregated funds from some investors. This outcome would not be in the best interest of consumers. Segregated funds must remain economically competitive for both investors and advisors. Many retail investors will be unable or unwilling to pay significant upfront fees for the financial advice that they require. However, trailing commissions may simply be uneconomical for firms and financial professionals when dealing with investors with limited investible capital.[3] The DSC was one tool to address this conundrum; however, the potential harms to investors associated with this tool have led regulators to ban its use.

FSRA must carefully assess other incentive structures to ensure that consumers remain protected without depriving them of access to valuable advice and products. Advisors need to be paid for the value they provide and all incentive structures carry some risk. The correct balance must be struck in managing those risks in accordance with the Fair Treatment of Customers. Permissible incentive structures adequately compensate advisors without imposing unnecessary burdens on investors or creating unmanageable conflicts of interest.

A Simplified Proposal

In implementing the DSC ban, we urge FSRA to adopt a simplified approach: prohibit new segregated funds with DSCs, prohibit future deposits under the DSC option, and allow existing DSC schedules to run their course.

This simplified proposal would reduce the cost to industry, eliminate consumer confusion, and result in easier to understand rules.

FSRA's current proposal potentially requires industry participants to prepare and deliver multiple different disclosure documents. One set of disclosure documents is required if a particular segregated fund contract does not allow the insurer to unilaterally remove the DSC option for future deposits. A second set with a default option is required if the contract permits the amendment by the insurer but there are customer instructions for new deposits to be made under the DSC option. Creating and delivering these disclosure documents and processing customer elections will impose additional costs on the industry. These costs can be avoided by adopting a simplified approach.

Additional disclosure may also lead to consumer confusion. As FSRA knows, more disclosure does not directly equate with increased customer understanding. Lengthy or confusing disclosure documents are often disregarded by busy consumers. In the case of DSCs, if FSRA

[3] The CLHIA reports that FEL-0 represents 43% of sales in segregated fund accounts at $200,000 and above. However, that declines to 31% in segregated accounts at $50,000 and below. Other incentive structures are needed to allow advisors to economically offer segregated funds to clients with smaller pools of investable capital. "Data to Advocis – CCIR Upfront Commissions for Segregated funds," CLHIA Discussion Paper, October 28, 2022.

believed that the consumer harms could be adequately addressed by disclosure, then the ban would be unnecessary. Therefore, we propose a simplified approach which would eliminate the need for significant additional disclosure.

Like the FSRA proposal, the simplified approach would prohibit new sales of segregated funds with a DSC option. For existing segregated funds contracts, the DSC option would not be applied to future deposits. Where the insurer can unilaterally eliminate the DSC for future deposits, it should do so (and provide notice to customers when they make a deposit). Where the insurer cannot unilaterally eliminate DSCs for future deposits, future deposits should be made under a new contract. Finally, existing DSC schedules should be allowed to run their course.

It is not clear to us that the customer benefit from being allowed to make additional deposits subject to a DSC outweighs the significant costs and risks outlined above, namely disclosure/implementation cost and consumer confusion. Any potential benefits are further reduced by the work that industry has already undertaken towards phasing out DSCs.

A simplified approach would also help simplify understanding and compliance with the proposed rules. We applaud FSRA's commitment to plain-language communication and urge it, wherever possible, to issue easy-to-understand rules for industry. Unfortunately, the proposed amendments, as drafted, are difficult for industry and the broader public to understand.

In the alternative, FSRA could implement the DSC ban on new segregated funds under the UDAP rule-making power and defer the rules for deposits under existing contracts until the segregated fund rule-making power is proclaimed into force. The segregated fund rule-making power would allow a more easily understood and tailored rule to be enacted.

3. CONCLUSION

We welcome the work that FSRA does to ensure a fair and efficient marketplace for segregated funds in Ontario.

We urge FSRA to continue to consider a simpler approach to deposits under existing segregated fund contracts. We also remind FSRA of the valuable role that segregated funds play in Ontarian's financial futures. We hope that regulatory changes do not limit access to these financial products.

We look forward to further productive discussions with FSRA on the issues highlighted in this submission. Should you have any questions, please do not hesitate to contact the undersigned, or James Ryu, Vice-President, Advocacy and General Counsel at jryu@advocis.ca.

Sincerely,

"original signed by"

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