

July 15, 2016

**BY EMAIL**

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Dear Sirs/Mesdames:

**Re: Canadian Council of Insurance Regulators – Segregated Funds Working Group  
Issues Paper, May 2016 (the “Paper”)**

The Canadian Advocacy Council<sup>1</sup> for Canadian CFA Institute<sup>2</sup> Societies (the CAC) appreciates the opportunity to provide the following general comments on the Paper and respond to the specific questions referenced below.

The CAC strongly supports the dialogue and initiative started by the CCIR to review the disclosure and other regulation that involve the sale of segregated funds and products that are similar to investment funds sold to retail investors. As noted in the Paper, the requirements for disclosure and other registrant competencies surrounding the sale of mutual funds have increased materially over the last 10 years and the requirements with respect to the sale of IVICs has simply not kept pace.

Given the dual registrations of many insurance salespersons with a securities regulatory agency or SRO, we are of the view that promoting greater consistency of regulation across Canada would benefit both consumers and the insurance industry. While the insurance guarantee and term should be apparent differentiators, segregated fund products which are technically insurance products may look very similar to other fund products to many investors, and as noted above, might also be offered by the same advisor. Consistent regulation would result in regulatory efficiencies, cost savings and consistent fair treatment of clients as well as negate regulatory arbitrage opportunities, and thus harmonization should continue to be a primary goal of the CCIR.

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<sup>1</sup>The CAC represents more than 15,000 Canadian members of the CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at <http://www.cfasociety.org/cac>. Our Code of Ethics and Standards of Professional Conduct can be found at <http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx>.

<sup>2</sup> CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 135,000 members in 151 countries and territories, including 128,000 CFA charterholders, and 145 member societies. For more information, visit [www.cfainstitute.org](http://www.cfainstitute.org).

## **Questions re Charges and Compensation Reports**

1. *What enhanced disclosure of charges and other compensation for IVICs would encourage intermediaries and consumers to examine more closely the products recommended and purchased? Please explain.*

The charges and compensation that are required to be disclosed should be the same categories of charges and compensation that mutual funds and mutual fund dealers are required to disclose, including as a result of the full implementation of CRM2. It would be much easier for investors to compare product features, costs and risks if those elements were described in the same manner for IVICs as for mutual funds.

Investors must be provided with timely, accurate and easy to understand disclosure about all investment charges, to help assess performance of their advisor and their investments. Full transparency should help keep costs at a competitive level.

2. *How else might better disclosure and transparency be achieved by the IVICs industry?*

As noted above, better disclosure and transparency can be achieved through regulatory harmonization.

## **Questions re Brokerage Arrangements (“Soft Dollars”)**

3. *What would be the most effective method of ensuring that IVIC consumers were aware of soft dollar arrangements and other sales incentives?*

While we agree that it is important for IVIC consumers to be aware of any soft dollar arrangements, we do not think that the potential issues raised by the use of soft dollars should be confused with the very serious potential conflicts of interest that can be raised through sales incentives. Properly incurred soft dollars are investment management expenses that are paid for by the fund, and should be disclosed to investors, and the rules for incurring such expenses and disclosure of same should be harmonized to those required of mutual funds. With respect to sales incentives, we do not see any compelling reason to differentiate the disclosures required of securities registrants and IVIC salespersons, including with respect to disclosure of referral fees and commission amounts. The disclosure to clients of sales compensation is essential transparency for clients to understand the services for which they are compensating their advisors.

## **Question re Account Performance**

5. *How should account performance reports for IVIC contract holders be harmonized with those on the mutual fund side? What adjustments could be made to take into consideration IVIC's guaranteed protections?*

The account performance reports for IVIC contract holders should be harmonized with the requirements of CRM2 applicable to the performance reports for mutual funds. The reports can contain factual notations with respect to the existence of, term and limitations of the guarantee. As a material feature of an IVIC contract, all the features of the guarantee must be disclosed prominently in plain language. In particular, the limitations of the guarantee should not be obscured and should be displayed upfront.

We note that while CRM2 requires the performance reports to use a dollar-weighted method of return calculation, we would have preferred a requirement to use the time-weighted method of return in order to determine how an investor's portfolio value has changed as a result of actions of the investment manager. However, to preserve the primary goal of harmonization we would suggest that any new regulations mandate the use of the dollar-weighted calculation but encourage a secondary time-weighted calculation. Using both methods of calculation on the same performance report will result in similar values most times, but if any differences arise they should be explained in the performance report in plain language.

In our experience, investors find it easier to understand the dollar cost of charges rather than only a percentage figure. We believe that wherever a percentage cost is listed in disclosure, a corresponding dollar amount per \$1,000 of investment should also be provided.

### **Questions re Product Performance**

6. *Are IVICs generally considered to be held as a long-term investment compared to other types of investment products?*

Yes, IVICs are generally considered to be held as a long-term investment. However, the impact of early redemption provisions on the expected return must be disclosed to and explained clearly to investors by the IVIC sales representative.

7. *To what extent should the enhanced investment performance data requirements be harmonized with mutual fund rules?*

The investment performance data requirements should be fully harmonized with those applicable to mutual funds, which will make it easier for investors to understand the potential risks and rewards of the products. The insurance component obviously differs from conventional mutual funds, but can be disclosed alongside the performance data as suggested in our response to Question #5 above.

9. *What differences could be made to take into account the guaranteed protections in an IVIC?*

The material features of the insurance guarantee should be disclosed, primarily its term, limitations and restrictions, together with any early redemption fees and the impact of those fees on potential investment performance.

### **Question re Disclosure upon Subsequent Fund Purchases**

10. *Are there any reasons why segregated fund investors should not receive updated Fund Facts upon subsequent investment in the same fund?*

We are not aware of any reasons why segregated fund investors should not receive updated Fund Facts upon subsequent investment in the same fund. The Fund Facts disclosure requirements should be harmonized to the format and timing requirements of those required for conventional mutual funds.

## Question re Risk Classification Methodology

11. *What risk classification methodology do you believe is most appropriate for segregated funds and how should this be disclosed?*

For comparison purposes, we believe it is important for segregated funds to utilize the same risk classification methodology that is finalized by the Canadian Securities Administrators. We understand that the guarantee is an additional complexity that does not directly compare to mutual fund products, but the underlying product should be comparable and thus the same risk classification methodology can be used, with some additional disclosure around the guarantee and the risks thereof.

We are generally supportive of a standardized risk methodology. While we have some concerns on the use of standard deviation as the sole risk indicator since we believe volatility is only one important risk measure, as an interim step to potential future changes, it would be most helpful if the requirements were harmonized. We understand that under the CSA proposals, the investment risk level of a mutual fund may be increased beyond the level in which it might otherwise be placed based on the methodology. We have encouraged the CSA, and would encourage the CCIR, to provide additional guidance with respect to when such an increase might be appropriate. The Journal of Finance has recently published a paper [A Risk and Complexity Rating Framework for Investment Products] (Koh et al.) discussing a complexity rating framework, which would help inform and augment traditional risk ratings. The paper describes other vectors that could be considered for risk measurement and required mutual fund and ETF disclosures in future projects. The CAC would be happy to engage with interested CCIR working groups on this point for a more detailed dialogue in future.

## Questions re IVICs

12. *What should be the responsibilities of life insurance companies with respect to oversight of IVIC sales and their distribution? What factors affect the ability of life insurance companies to oversee IVIC sales?*

Life insurance companies should have the same responsibility as investment fund dealers/exempt market dealers with respect to oversight of IVIC sales and their distribution. Sales representatives should have the same Know-Your-Client and Know-Your-Product obligations as dealer representatives, and insurance companies should have similar compliance oversight responsibilities. Insurance companies should be required to have fully developed compliance systems and controls, as well as a Chief Compliance Officer (or equivalent) who is dedicated to IVIC products and is responsible for day to day compliance requirements and the supervision of employees selling IVIC products.

13. *What should be the responsibilities of intermediaries with respect to IVIC sales?*

Sales representatives should have the same Know-Your-Client and Know-Your-Product obligations as investment dealer representatives.

14. *What could the industry do to address issues with insurer and intermediary supervision of the distribution and suitability assessment of IVICs?*

It will be important to set out specific KYC and KYP requirements for insurer and intermediaries which are similar to existing and proposed CSA requirements. The intermediaries must take steps to ensure they understand the investment needs and objectives of the investors, as well as their financial situation and tolerance for risk. With respect to KYP, intermediaries should be able to understand and explain to clients the structure and features of an IVIC, including structure, risks and costs (included embedded costs) and insurers should provide training to support these processes. Regulators are in a good position to implement, monitor and enforce such requirements.

### **Questions re Standard of Care for Life Insurance Intermediaries**

15. *To what standard of care should individuals who advise on and sell IVICs be held? Please explain.*

Individuals who advise on and sell IVICs should be held to the same standard of care as securities registrants. To the extent the current CSA consultation with respect to implementing a regulatory best interest standard proceeds [CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients (the “**CSA Consultation Paper**”)], individuals who advise or sell IVICs should be held to the same regulatory standard to deal fairly, honestly and in good faith with clients and act in clients’ best interests.

16. *Should the “know your client” / “know your product” standards as used in the securities sector apply to the sale of IVICs?*

The same KYC and KYP standards as used in the securities sector should apply to the sale of IVICs.

17. *What requirements for updating client information should apply to IVICs intermediaries?*

The same KYC update requirements as used in the securities sector should apply to the sale of IVICs. For example, the CSA Consultation Paper suggests that registrants should be required to take reasonable steps to update their client’s KYC information at least once a year, and more frequently in response to material changes in circumstances.

### **Questions re Conclusion**

19. *Are there other disclosures or requirements that have not been considered in this Issues Paper that would help achieve such a harmonized outcome?*

As noted above, harmonization should be a primary goal of the CCIR. While harmonized outcomes are important, we believe it is just as important that investors be presented with meaningful information about IVICs in a comparable format to that required to be disclosed for mutual fund products.

The guarantee portion of IVICs may not be well understood by retail investors, and thus disclosure with respect to its risks and limitations in prominent, plain language is important. We agree with the comments made in the Paper to the effect that in certain circumstances, investors could be overwhelmed with too much information and/or with information that they do not understand thoroughly. For any new disclosure obligation, it is important to consider whether clients will be more informed and better able to make decisions.

### **Concluding Remarks**

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have or to meet with you to discuss these and related issues in greater detail. We appreciate the time you are taking to consider our points of view. Please feel free to contact us at [chair@cfaadvocacy.ca](mailto:chair@cfaadvocacy.ca) on this or any other issue in future.

(Signed) *Michael Thom*

**Michael Thom, CFA**  
**Chair, Canadian Advocacy Council**