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The Canadian Association of Financial Institutions in Insurance | L'association canadienne des institutions financières en assurance

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Agenda Item 5(b)
October 29/20 EOC Meeting

Briefing Document on the Financial Consumer Protection Framework (FCPF) Components of Federal Bill C-86; and Related Development Of An "Appropriateness Guideline"

Status of the Financial Consumer Protection Framework (FCPF) Components of Bill C-86

A summary of the key provisions of federal Bill C-86 issued by the law firm Torys[1] on 30 April, 2020 states that "the *Bank Act* amendments introduced in Bill C-86, which provided for a consolidation and strengthening of the consumer provisions found in the *Bank Act*, have not been proclaimed into force by this Order in Council."

Therefore, the provisions of Bill C-86 related to the appropriateness for consumers of financial products and services offered by federally regulated financial institutions are contained in the legislation but they are not yet in-force.

Further, as indicated by recent CAFII conversations with FCAC staff executives (see "FCAC Plans For Developing An Appropriateness Guideline" below), exactly how those appropriateness provisions will be defined, monitored, and enforced has yet to be considered and developed.

Torys' analysis also notes that the FCPF contains *"a new provision, which is favourable to the banks, requiring the FCAC to balance their duty to protect consumers' rights with the 'need of financial institutions to efficiently manage their business operations.' "*

Suitability and Appropriateness Tests for Insurance Products in the European Union

On 1 October, 2018, the European Union implemented a new "Insurance Distribution Directive" which introduced a regime for the selling of insurance-based investment products (IBIPs). Under this directive, if advice is being provided, a "suitability" test must be performed. In contrast, if no advice is being offered, an "appropriateness" test has to be performed.

The EU directive's appropriateness test consists of one criterion only: "the customer's knowledge and experience in the product's investment field, from which it should be determinable how well he/she can understand the risk involved." Furthermore, "if the customer fails to provide this information, or if he/she lacks knowledge and experience for the IBIP in question, then the distributor must issue a warning stating that the IBIP is not appropriate for the customer."[2]

[1] To see the analysis, see https://www.torys.com/insights/publications/2020/04/mandatory-naming-greater-penalties-and-clarified-objectives-the-new-fcac-provisions
[2] Source: https://blog.kpmg.lu/how-to-assess-suitability-and-appropriateness-under-the-idd/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration

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However, that said, EU member states may allow the appropriateness test to go unperformed if all of four conditions are met:

1. *The sale contract contains MiFID II non-complex financial instruments or it contains non-complex IBIPs.*
2. *The idea to buy the IBIP is initiated by the customer.*
3. *The customer is made aware that the test is being skipped, and that he/she therefore will not benefit from its protection.*
4. *There are no conflicts of interest.*

New Financial Products Suitability Law In Australia

In April 2019, Australia's parliament (House of Representatives and Senate) passed a new financial products suitability law very similar to the UK's MiFID II-based regulations, which made Australia the second major global market to adopt a financial products suitability standard.

This was a major departure in how Australia's financial services sector is regulated. Previously, regulation was based on the notion that disclosure of product characteristics, fees and risks meant the client could make an informed choice. The new suitability law is rooted in a recognition that disclosure regimes fail to adequately protect consumers. Disclosure continues under the new regime, but with suitability overlaid.

At the same time, Australia's *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019* extended a regime of senior executive accountability and responsibility introduced in 2018 from coverage of just banks to include senior management in the broader financial services sector, including insurance.

These new rules impose responsibility for product design and distribution to ensure products are targeted at the right consumers. Breaching the product design and distribution rules now attracts civil and criminal sanctions: criminal – up to $42,000 fine or five years imprisonment or both; civil – maximum of $200,000 for individuals or $1 million for a corporate entity. A client who suffers loss or damage may also take civil action against the advice-giver.

The rules will apply to product issuers; Financial Services License holders; authorised representatives of a licensee; and sellers of financial products where a Product Disclosure Statement or a disclosure document are required.

The products covered are

- financial products requiring disclosure by Product Disclosure Statement (PDS);

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- products requiring disclosure under Fundraising provisions of Corporations Act (Part 6D.2), or are exempt via a mutual recognition scheme with New Zealand;
- those products made subject to the regime by Ministerial discretion — regardless of whether disclosure is required.

The new law (i) imposes responsibility for product design and distribution to ensure products are targeted at the right consumers; (ii) as part of the product design rules, the Australian Securities and Investments Commission (ASIC) has been given intervention powers to regulate or ban potentially harmful financial products that risk consumer detriment. Significantly, in urgent cases, interim orders can be made to immediately restrict, modify or ban a financial product without any consultation or comment from the product issuer.

ASIC must consider the nature and extent of detriment including actual or potential losses and the impact on clients. ASIC can issue a stop order for:

- failing to make a target market determination;
- advising on or selling a product without a determination; and
- failing to take reasonable steps to comply with a determination.

ASIC must satisfy consultation and notification obligations before an intervention order is made and affected parties must be given the opportunity to make submissions to a hearing prior to an intervention being issued.

Intervention orders are made public on the ASIC website and are usually in force for up to 18 months (but can be extended). Intervention powers are not retrospective and only apply to products issued after April 2019. There was no transition period as such, with the stop-order powers applying from the day the law was proclaimed.

FCAC Plans For Developing An Appropriateness Guideline

Through recent CAFII conversations with Frank Lofranco, the FCAC's recently appointed Deputy Superintendent, Supervision and Enforcement, and some of his FCAC staff executive colleagues, we have learned the following about the FCAC's plans to develop an "appropriateness guideline":

W*e are not planning to develop an appropriateness provision or a test. The Financial Consumer Protection Framework (FCPF) in the Bank Act (once in force) includes a provision on "appropriate products." The FCAC plans to develop a guideline for industry that will articulate our perspective and expectations related to that provision.*

What guidelines are is explained in section 4.3.1 of FCAC's Supervision Framework (https://www.canada.ca/en/financial-consumer-agency/services/industry/supervision-framework.html).

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So we plan to develop a guideline focusing on the "appropriate products" provision in the FCPF to assist regulated entities in complying with market conduct obligations. We have not landed on the exact content of the guideline, or the specificity of whether/how certain products or services will be incorporated. Significant development work remains, as does consultation with the Industry and the public.

As a first step, we plan to consult with the Industry Working Group put in place to assist in the implementation of the FCPF. We are targeting that discussion/consultation for late fall 2020, or early winter 2021.

A public consultation (which includes all industry, stakeholders, the public) on the draft appropriateness guideline will take place following that initial targeted consultation.

Implementation of the FCPF falls under Brad Schnarr, the FCAC's Manager, Supervision and Enforcement. Mr. Schnarr confirmed that Stephen Wild, Senior Research & Policy Officer, who reports to Mr. Schnarr, who in turn reports to Frank Lofranco, Deputy Commissioner, Supervision and Enforcement, will be the lead on drafting the appropriateness guideline for financial products which is embedded within the FCPF section of Bill C-86 which received Royal Assent in December 2018.

Canadian Bankers Association Work on Appropriateness Guideline Cannot be Shared with CAFII

On 5 October, 2020, Brendan Wycks wrote CBA staff executives requesting a teleconference meeting to share information on the work which CAFII and the CBA have done on the FCAC appropriateness guideline, to which Aaron Boles, the CBA's Vice-President, Communications, replied:

> *Thanks, Brendan.*
>
> *The CBA and our member banks engaged external counsel on the "Appropriateness Guideline." However, this work can't be shared outside of the CBA according to the terms of the engagement with the firm. As to the outcome of your conversations with Frank and Brad, we've had similar, direct conversations with them about the guideline.*
>
> *So, at this point, we don't think there's a compelling need for a conference call.*
>
> *Best regards,*
> *AEB*

Position of CAFII Board Members on the Appropriateness Guideline

One CAFII Board member has suggested to CAFII management that the Association should consider getting out in front of the FCAC's appropriateness guideline by developing industry positions on the provisions that are likely to be contained in that guideline -- to forestall the likelihood that the FCAC will include excessive or unnecessary provisions in its appropriateness guideline. More specifically, this Board member sees three possible areas where CAFII could attempt to develop industry positions.

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First, at the time of onboarding, there could be an eligibility test for the client signing up for a credit protection insurance (CPI) product. For example, if the client is signing up for job loss insurance, they would be asked a question to confirm that they are working the minimum number of hours required to be eligible for the insurance.

Second, the industry could commit to a fair treatment of customers practice of not signing up a client for a CPI product unless there was a strong probability that the client would be paid out if he/she was ever to make a claim.

Third, because a consumer's status changes as his/her life evolves, it is possible that a client may be eligible for a CPI product at the time of onboarding; but then their status changes at some point and they become ineligible. Banks do not have the data to monitor such developments, so CAFII could articulate a consumer responsibility expectation that clients should understand their coverage and notify their provider if their status changes.

Another Board member is of the view that CAFII's emphasis in dealing with the coming FCAC appropriateness guideline should instead be on educating the FCAC on the controls and compliance functions that exist in CAFII member institutions offering CPI, with the intention being to persuade the FCAC that the appropriateness guideline does not need to apply to CPI.
The FCAC may be focused on parts of the banking sector which are more lightly regulated and which have lighter controls over sales activities than is the case for CPI. CPI is strongly monitored and controlled, there is strong internal compliance oversight of the activities around these products, and it is strongly regulated by federal and provincial regulators. As such, the FCAC's objectives around customer protection are already being met by the existing framework. An additional appropriateness guideline is therefore not necessary for CPI; and having an appropriateness guideline for CPI would be problematic, in any event, given that these products are sold by unlicensed agents who cannot provide advice to consumers.