



Canadian Life  
and Health Insurance  
Association Inc.

Association canadienne  
des compagnies d'assurances  
de personnes inc.

June 6, 2002

Ms. Rebecca Cowdery  
Manager, Investment Funds Regulatory Reform  
Ontario Securities Commission  
P.O. Box 55, 19<sup>th</sup> Floor  
20 Queen Street West  
Toronto, ON M5H 3S8

Dear Ms. Cowdery:

The Canadian Life and Health Insurance Association (CLHIA) is pleased to provide these comments on Concept Proposal 81-402 of the Canadian Securities Administrators (CSA), *A Framework for Regulating Mutual Funds and their Managers* (Concept Proposal).

### **About CLHIA**

The CLHIA, established in 1894, is the trade association representing the life and health insurance industry in Canada. It has 75 member companies, accounting for 98 percent of the life and health insurance business in Canada. Virtually all of the Canadian life insurance companies offering segregated funds are members of the association.

Working in close consultation with the Canadian Council of Insurance Regulators (CCIR), the CLHIA has responsibility for developing the *Guidelines on Individual Variable Insurance Contracts Relating to Segregated Funds*. These guidelines, which are approved by the CCIR and adopted as regulation by the Province of Ontario, establish standards for disclosure to clients, audit and accounting procedures, investment restrictions and corporate governance, among other things. As well, any insurer that proposes to offer an individual variable insurance contract to the public must file documents evidencing the contract with the CLHIA to be reviewed for compliance with the guidelines. CLHIA then issues a comfort letter to accompany the formal filing of documentation with the provincial and territorial insurance regulators.

### **Scope of Comments**

The CLHIA will limit its comments to addressing one specific question posed in the Concept Proposal, that is, Question 4: "Which parts of our renewed regulatory framework should be extended or not extended to other investment vehicles – and which investment vehicles?" In particular, we will be responding to comments about segregated funds and the initiative of the Joint Forum of Financial Market Regulators to harmonize the regulation of mutual funds and segregated funds.

1 Queen St. East  
Suite 1700  
Toronto, Ontario  
M5C 2X9

1, rue Queen est  
Bureau 1700  
Toronto, (Ontario)  
M5C 2X9

Tel: (416) 777-2221  
Fax: (416) 777-1895

Tél: (416) 777-2221  
Fax: (416) 777-1895

**Toronto**

**Montreal**

**Ottawa**



## Recommendation and Rationale

After carefully reviewing the details of the Concept Proposal, the CLHIA submits that the proposed framework should not be extended to individual variable insurance contracts related to segregated funds.

The reasons behind this recommendation are three-fold. First, at a high level, there is a striking structural similarity between the model in the Concept Proposal and the governance regime already in place in the segregated funds industry. Second, the governance principles set out in the Concept Proposal and protections to investors associated with these principles are, for the most part, the same as those in place for segregated funds. And third, the statutory requirements for board oversight in the segregated funds industry also provide for effective self-regulation that gives companies discretion to determine the content of specific policies and procedures.

The comments that follow focus on the governance aspect of the concept proposal but the rationale above applies equally to the other pillars of the framework. Specifically, the proposal to register mutual fund managers effectively duplicates a requirement in the *Guidelines* that an insurance company have in place procedures to ensure that investment managers of segregated funds are suitable.

## Harmonization

The Joint Forum released its 100-point comparison of segregated funds and mutual funds in May 1999. Later that same year, as the Concept Proposal notes, the Joint Forum recommended 15 areas where harmonization could be undertaken. This includes governance.

In contemplating any proposals for harmonization or extending the regulatory regime of one product to another, several important considerations should be kept in mind. First, the Joint Forum noted in the preamble to its December 1999 recommendations that "since there are fundamental differences between the products, harmonization of *result*, rather than harmonization of *rules* should be the goal" (emphasis in original). Second, in its specific comments regarding regulation of manufacturers, the Joint Forum suggested that "regulatory requirements applicable to manufacturers need to reflect the nature of the product, its regulation and the roles undertaken by the manufacturer." On this point, the CCIR 1969 Report of the Canadian Committee on Mutual Funds and Investment Contracts recommended that any attempt to apply regulations designed for mutual funds, without modification, to segregated funds would produce problems. Finally, in that same 1969 report, the Committee recommended that "the formulation of the necessary modifications (for greater harmonization) should be done in the context of life insurance legislation generally, and ought therefore to be carried out under the aegis of the Superintendents of Insurance, federal and provincial."

It is worth noting, as well, that the Joint Forum's analysis and recommendations in the area of governance focused attention on the absence of a legislated governance regime for the mutual fund industry. In fact, the May 1999 comparison report clearly established the strength of the life insurance industry in the areas of capital requirements and governance. This is especially



important in the current context because the governance regime for federally regulated life insurers, and thus segregated funds, has been significantly enhanced since those recommendations.

### **Legislative Compliance Management System (LCMS)**

In May 2000, the Office of the Superintendent of Financial Institutions (OSFI) issued Interim Guideline E-13 giving direction to federally regulated financial institutions regarding compliance with applicable rules and standards. Federally regulated life insurance companies (more than 80 percent of CLHIA's membership and virtually every provider of segregated funds) were further directed to have a LCMS in place by the end of the year.

The LCMS is based on a supervisory framework that OSFI had released the previous year. Under this framework, OSFI oversees the Board of Directors of a life insurance company; the Board, in turn, oversees senior management of the company and senior management oversees compliance and compliance officers.

OSFI does not prescribe how a life insurance company should monitor compliance. In fact, it expects that the systems will vary from company to company depending on structures and individual company operations. It does, however, expect each system to have a number of attributes or elements. These are:

- Regular reporting of management to the Board and documentation;
- Assignment of responsibility for compliance to a senior officer with appropriate resources and authority;
- Assignment of responsibility for administration of LCMS to designated officers in business units;
- Periodic reporting of compliance problems by designated officers and status reports on outstanding problems and solutions;
- Periodic review by management of effectiveness of LCMS; and
- Periodic independent review of LCMS.

Working in close consultation with OSFI, CLHIA developed industry-wide techniques for implementing the LCMS. As well, CLHIA has developed a number of guiding materials that address business practices relevant to the LCMS. For example, there is a model code of business ethics and conduct for employees, a description of the functions and responsibilities of a Chief Compliance Officer and a mandate for a compliance program. Finally, to assist companies in effectively monitoring compliance, CLHIA has developed a database of compliance requirements and related compliance management applications.

### **Achieving CSA's Objectives**

We submit that the current governing legislation together with the governance regime for life insurance companies that is described above and already in place meets the CSA's objectives for protecting clients who purchase segregated funds.



The *Insurance Companies Act of Canada* (ICA) prescribes key requirements that establish the size, qualifications and independence of the Board of Directors; the make-up and responsibilities of committees that supervise senior management; a standard of care and provisions to address conflicts of interest. In addition, the ICA contains provisions that address the election and tenure of directors, requirements for meetings and reporting to shareholders. Moreover, the ICA gives the Superintendent the power to remove a director if the Superintendent believes the director is not suitable. Finally, commencing in the fall of this year, the performance of each Board of Directors, senior management, compliance, risk management and other control functions will be assessed and rated by OSFI.

Of equal importance, in terms of assessing the life insurance industry's governance regime against the Concept Proposal, the LCMS, out of necessity, is designed to accommodate multiple products and services. What is more, the model has a proven capacity to adapt to changing circumstances. This has been evidenced most recently in the accommodation of money laundering and anti-terrorism provisions. As well, provincial market conduct requirements have been added to the LCMS thus avoiding the need to establish separate and duplicative monitoring functions for provincial legislation.

### **Common Interest**

The CLHIA shares the CSA's interest in ensuring that effective corporate governance is in place to protect the public generally and a company's customers in particular. We believe that the LCMS has proven itself to be capable of supervising the operations of life insurance companies in such a way as to safeguard the current and future interests of their customers. While we do not believe there is any need to extend application of the CSA's Concept Proposal to include segregated funds, we would be pleased to provide the CSA with additional details about this model for corporate governance and the experience of the industry in implementing it.

Sent electronically by: \_\_\_\_\_

J-P Bernier

Vice President and General Counsel