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'Serious consumer protection concerns': Insurance watchdog moves to ban controversial fee

Deferred sales charges ban comes after mutual fund industry eliminated similar practice that can result in hefty commissions levelled on customers

Barbara Shecter

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Ontario's insurance regulator is moving to ban controversial deferred sales charges on certain investment products saying they pose serious "serious consumer protection concerns." PHOTO BY GETTY IMAGES

A Canadian regulator is moving to end a controversial commission on segregated funds sold by insurance companies, following a similar ban in the mutual fund industry.

STORY CONTINUES BELOW

The Financial Services Regulatory Authority of Ontario (FSRA) is proposing to eliminate deferred sales charges (DSC) — a potentially hefty commission levelled on customers who withdraw funds before the end of a contract — on new segregated fund contracts beginning June 1, 2023.

The proposal, if it becomes a rule, would also restrict the use of DSC commissions on existing segregated funds, which are insurance products with investment features.

After years of complaints from consumer and seniors' advocates, provincial securities regulators announced bans on DSC charges for mutual funds in 2019 and 2021. In some cases, regulators found, seniors had been sold mutual funds with contracts of up to seven years and were charged significant fees if they took out their money any sooner.

The ban in the mutual fund industry prompted the new proposal from FSRA, which regulates the insurance industry in Ontario.

“We have heard that consumers feel they have been unfairly treated when they are required to pay early redemption fees to access their own investments,” said Russ Courtney, a spokesperson for FSRA. “Given that deferred sales charges have already been banned in mutual funds, it was important to ensure that regulations addressed concerns regarding these fees in segregated funds.”

Huston Loke, executive vice-president of market conduct at FSRA, said the commissions raise “serious consumer protection concerns” because customers may need access to their investments before the end of a contract.

In the debate over their use in the mutual fund industry, investor advocates argued that there was an inherent conflict of interest because the longer-term commitment with the prospect of early redemption fee would be arguably more beneficial to the fund seller than to the investor.

"Insurers and agents in Ontario need to treat customers fairly and provide them with product options that suit their needs," Loke said.

The planned changes, which require two separate amendments to FSRA's Unfair or Deceptive Acts or Practices Rule, would address investor protection concerns by giving customers control over and access to their money and the freedom to "sell, move, or redeem funds as needed," Courtney said.

Consultations are being held through Feb. 23, and interested participants can make written submissions to FSRA.

While the national ban on deferred sales charges on mutual funds came into effect in June, Canada's largest capital markets regulator, the Ontario Securities Commission, did not initially join other provincial watchdogs in eliminating the commission option.

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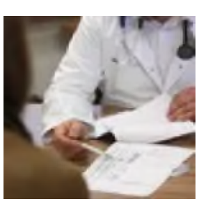

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Though initially in favour of an outright ban, the OSC instead opted to place restrictions on the use of deferred sales charges following a rare public disagreement with the Ontario government over its plans in the fall of 2018.

The OSC capped client age, hold period and dollar value, and insisted that redemption fees be waived in cases of financial hardship, but critics complained this would not deal with inherent conflict of interest in the compensation model and would only partially mitigate investor harms identified over months of study — in addition to complicating Canada's already fragmented regulatory system.

In May 2021, the OSC announced it would impose an outright ban on the DSC commission option on mutual funds, joining its dozen provincial and territorial counterparts and "harmonizing the DSC ban across Canada."

• Email: bshecter@nationalpost.com | Twitter: BatPost

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