

AUGUST 2002

\$5.50

# FORUM

THE MAGAZINE FOR INSURANCE AND FINANCIAL ADVISORS

**Reinventing  
the CLU**

**Compliance –  
friend or foe?**

**Killing accidental  
death insurance**

## THE BRAND IDENTITY

Advisors use branding to target clients



CAIFA



## THE Compliance Juggernaut

### Protecting Canadian investors

**C**onvergence, consolidation, re-trenchment, regulatory authority, raising the bar, know your client, money laundering, due diligence, conflict of interest, offshore, onshore, agency, independent, ... Compliance ... Compliance... Compliance ... just shoot me.

When is enough regulation too much? Is there no place left for "caveat emptor". Well, that depends on whom you ask and what sector of the investment industry you are speaking with. There are now some 80,000 licensed men and women to advise the investing public in some form or another. Here is a view of how the new compliance regime has affected their business culture.

#### STOCKBROKERS

Stockbrokers don't know life any other way. The only way they would know if they were in compliance pain; would be if it quit. Compliance has been with them from the very first day of their training. Traditionally, this is the place where the big money is won or lost, on single stock purchases. The brokers themselves are well trained and responsible to the TSE, Securities Commission (Provincial) plus the internal compliance rigor of their firm. As a new broker and a member of the Investment Dealers Association (IDA), the advisor must pass the Securities Course and for the next 30 months they are continually required to take courses, pass tests and generally be informed and educated on what to do and what is expected of them. No system is fail-proof. A recent example of concern was BREX. Some of the most reputable firms on the street and their research / analysts were recommending this stock into the mistaken gold dust, not the individual brokers per se.

#### MFDA FIRMS

This is a new anomaly. The mutual fund phenomenon has been overwhelming. With over 4000 mutual funds to choose from it was thought by some that it should have its own regulatory body. So the Mutual Fund Dealers Association

(MFDA) was formed and is now separate and apart from the Investment Dealers Association. Many of the advisors who sell mutual funds are dual licensed, but not all. If the advisor is not selling individual stocks and bonds it is not compulsory they pass either the Securities Exam or the intense 30-month rigor of the IDA member. Remember that mutual funds were supposed to be safer and protect the investing public from heavy losses in a bad market. Oops! What the hell happened here?

Remember the scramble to supply mutual funds to the seemingly insatiable market? This frenzy caused suppliers to package groups of companies in the same investment sector and they were sold as sector hedges. And of course when that happens you have just rendered the entire group of companies to the same fate of the single stock, when prices fall cyclically, or on sudden events (i.e. airline stocks...9/11...high tech dot coms). Investors have effectively mitigated the main value of the mutual fund with this particular strategy and returned it to the speculation the original mutual funds were created to avoid.

Of course the old adage still exists... if it goes up, the client bought it... if it goes down the broker recommended it. That will soon be a saying in history. Some of the big concern that the MFDA is bringing to the regulatory party is "suitability". There is, and will continue to be more counseling on mix and individual tailored suitability, than trade execution. The good news here is that most of the internal compliance requirements for these MFDA firms have tougher guidelines than the Act itself. The advisor is always bound by the most stringent of the two should they differ or vary in any way.

#### NEW SHERRIFF IN TOWN... THE COMPLIANCE OFFICER

Traditionally, compliance officers have

been viewed by the investment industry as a necessary evil. Compliance officers were, by and large, middle management. They were politely locked up in their office in the morning and let out at 4 pm to go home. They were always seen as whining deal breakers who consistently got hung up on details that had nothing to do with the "art of the deal". High-end commission sales people would complain loudly and management would, all but silence the Compliance Department. Things have changed.

Ever since the Royal Trust debacle of high closings, Enron, Arthur Anderson and the events of 9/11, the security surrounding the movement of money has been high. Compliance officers are out of the closet and raging. They now interact at the highest levels of the investment industry with the full press backing of senior management. It

seems that the bigger and more sophisticated the firm, the heavier and more demanding the compliance requirements are on the advisors. Today compliance officers occupy vice presidential levels of large corporations. They have the power to stop a trade, an insurance policy and an advisor. Today's compliance officer is often a lawyer whom has served as counsel somewhere in the company prior to his position in Compliance. Others have come up through the ranks of the IDA, TSE, or their respective provincial securities organizations. At this point, compliance officers are invited in at the very early planning stages of any marketing or product launch consideration. Their influence is substantial and they know it.

#### INSURANCE

The new Compliance regime has been somewhat of a shock to the Insurance industry. Up until now, the Insurance agent has operated at the relationship level with very little involvement or scrutiny outside the firm. The questions that required answers were product type

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questions relating to health, benefit amount and beneficiaries. Insurance products now have become so sophisticated and their application so varied, that they are now and will continue to be a popular and versatile financial vehicle. Segregated Funds and Universal Life products deal with securities in “mutual fund like” manner. Securities and insurance produce a unique value when the securities are contained in the investment portion of the policy. Because more and more of this product is finding its way into the portfolio to address tax issues (unrealized capital gain) they have become an integral part of the overall mix and now have a place on the regulatory radar screen. Almost all MFDA advisors are selling insurance and it is beginning to command a stronger place in the IDA firms. Banks such as the Royal Bank are making huge strides into the Insurance market with storefront facilities.

The proposed new training program, Life Licensing Qualification Program (LLQP), was designed by regulators to be 270 hours of study before you even qualify to write the exam. All insurance/advisors/planners will have a higher standard for reporting and record keeping.

## ADVISOR REACTION

This is an interesting variable, depending with whom you speak. The over 40, experienced, long time advisor sees this regulatory upgrade as an unnecessary intrusion on their business practice. They see this as regulation designed to keep those employed who have never sold an insurance policy, stock, bond or option in their life, making the rules to ensure their jobs. Bureaucracy at its height. Most advisors especially in the Insurance and MFDA firms did their best to stay out of the big corporate companies to maintain their independence and escape such scrutiny. Not because they are less than honorable, it is simply that they like being their own boss with very little interference from large corporate structures. Compliance is corporate. It is a juggernaut that can't be stopped and you have to be part of something large to be engaged. And you must be engaged.

On the other hand, the younger under 30 advisors, is all for this raising the bar. Fresh out of school, complete with their Certified Financial Planning (CFP) certificate and academically ready for any

exam they say... “bring it on”. They work very hard to earn credibility, as it takes a lot to move clients from long time relationships of existing advisors. Enterprising and entrepreneurial rookies have made some very nice partnerships with some of the not so cynical veterans. Agreements of this kind between the two factions fold into operating companies that show real promise. This will provide a built in exit and sale of the clients for the more senior partner.

## THE REGULATORS & RULES

To address this section as anything less than a tangled web of power, ego, control and concern would be to understate a seemingly immovable force.

The last shall be first.

The concern is a healthy one. The fear is that something catastrophic will go wrong. For

example the scandal involving Enron's association with Arthur Anderson. Here in Canada criminal charges have just been laid against the management of Eron Mortgage Corporation (not to be confused with Enron) where approximately 3,000 BC residents were bilked out of their life savings (\$182 million) on the promise of double-digit returns. They (Eron) were providing a financial investment service to the public with little or no watchdog or prerequisite requirement to sell their wares. Once the receivers are called in, be certain, there will be nothing left for the investors. This concern is not just on the part of the Regulators. The firms themselves, many of them are now publicly traded companies. They know that a bad piece of business will find its way quickly to the media and that could crush the company.. Negative media is destruction from “from on high” and has little or no accuracy when it lands.

The rules are a nightmarish spider web that may never be unwound. In Canada, we have 13 different jurisdictions that govern the investment mentality and safety for Canadian investors. Thirteen separate kingdoms of power and control in the name of safety for their provincial citizens. Armed with this righteous indignation, powered by differing cultures, geography, language, political stripes, old scores, and agendas...who will be the first to agree to the suggestions of the Ontario Securities

Commission (OSC) that the entire country will be under one set of rules and regulations?

What is a hard and fast offence in one province is completely legal in another. Each province has its own Securities Commission, Insurance Council, Regulators, market watchdogs etc. with its own rules. For example a sophisticated investor (an exemption for experienced people to invest without all of the warning hoopla) is often measured by the investors wealth. In Ontario the number is (\$150,000) in British Columbia given the right circumstances, it's (\$25,000). Rebating (paying commission or finders fees to find clients), which is illegal in Ontario, but is legal in Alberta and British Columbia. Make sense?

Every government and territory believes it is their mandate to protect their constituents, and they're right. A politically divine right. And for that reason, they each have their regulators in place. Which one of these provinces are going to capitulate and change their modus operandi to standardize to the Ontario view for what is perceived to be, by many, the greater good? Would it be Alberta, British Columbia or Quebec?

Hmmm, yeah that's what I thought too.

## GOOD NEWS

The vast majority of financial advisors out there are very honorable, just like the people they represent. It was found that even in the event of forgery, one in every one hundred were malicious. The other ninety-nine were administrative forgeries. That is to say, the advisor made a visit to the client and forgot to have all of the papers signed. Rather than make another trip back they simply traced the signature to save time. Wrong, but not malicious. The internal audit systems are so tight in the reputable firms, that if someone is stealing or churning your account...they will be found out and dealt with severely.

Bottom line: The Canadian investor is quickly becoming the most protected and guarded investor in the world.

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