

April 5, 2022

Financial Services Regulatory Authority of Ontario  
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Attention: [Glen Padassery](#)  
Executive Vice President, Policy & Chief Consumer Officer

**Financial Services Regulatory of Ontario (FSRA) consultation on its approach to principles-based regulation (PBR), expected to enhance consumer protection, facilitate innovation and ultimately lead to more efficient and effective regulation.**

[Seeking input on proposed principles-based regulation approach guidance | Financial Services Regulatory Authority of Ontario \(fsrao.ca\)](#)

Kenmar appreciate the opportunity to comment on FSRA's consultation on PBR. Kenmar Associates is an Ontario-based privately-funded organization focused on investor education via on-line research papers hosted at [www.canadianfundwatch.com](http://www.canadianfundwatch.com). Kenmar also publishes ***the Fund OBSERVER*** on a monthly basis discussing consumer protection issues primarily for retail investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused consumers and/or their counsel in filing complaints and restitution claims.

The merits of PBR vs. rules has been debated for years. The biggest PBR risk is interpretive risk, the risk that an action will be interpreted differently by the FSRA and the regulated entity.

Consider the extreme example of a highway with a posted speed limit of 100 km/h. You can't drive faster than that, since that's "a prescriptive rule." Meanwhile, a principles-based law would require drivers to drive in a manner that is safe for road conditions, traffic conditions and taking into account the experience of the driver and quality of the vehicle. Such a system would require all drivers to accurately self-assess the scenario and make adjustments AND for highway patrol to judge the situation in the same way. This increases the regulatory onus on both drivers and police and could lead to material differences in interpretation and inconsistent enforcement and court decisions. The difficulty inherent in this regulatory approach is that it is impossible to determine, in a timely fashion, if the desired regulatory outcome is being achieved. This determination will only be available when sufficient accident data are obtained over a meaningfully long period of time. The absence of real-time feedback with PBR poses unique risks and challenges that FSRA may not be able or equipped to address.

Accordingly, Kenmar believe a combination of principles and key rules in high risk areas might constitute a more viable and effective approach at this time.

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## The PBR focus on outcomes

The arguments for PBR are compelling. PBR is based on the idea that Firms and their management are better placed than regulators to determine what processes and actions are required within their own businesses to achieve a given regulatory objective. Therefore, regulators should refrain from prescribing the processes or actions that Firms must take and instead define the outcomes that they want Firms to achieve. Firms and their management will then be free to identify the most efficient way of achieving the desired outcome.

Firms, often complain that they are being coerced to deliver on the FSRA's wider social objectives, but that is the point of regulation, to ensure that Firms operate in a manner that is consistent with the 'public interest', as defined by the regulator.

The outcome-oriented focus of PBR envisions a fundamental shift in the role and responsibilities of regulated entities within a regulatory regime. PBR requires that regulated entities actively, sincerely and meaningfully engage with principles at the highest level with a view to generating processes, practices and conduct capable of achieving desired regulatory outcomes. This contemplates both a more hands-on role for Boards of directors and senior management in their oversight and stewardship of regulatory compliance matters and a more strategic business role for Firm compliance, risk management, and audit personnel. Importantly, it also requires a change in the mindset of (many) regulated actors. .

The most commonly cited consumer outcomes are:

- Consumers can be confident that they are dealing with regulated Firms where the fair treatment of customers is central to the corporate culture
- Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly
- Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale
- Where consumers receive personalized advice, the advice is suitable and takes account of their circumstances
- Consumers are provided with products and services that perform as Firms have led them to expect
- Consumers do not face unreasonable post-sale barriers imposed by Firms to change product, switch provider, submit a claim or make a complaint.

A challenge for the FSRA will be designing a transparent PBR compliance system capable of assessing whether the desired outcomes are being consistently met by the regulated entities.

The central question is: Can PBR, as proposed and overseen, by the FSRA deliver these outcomes?

There are potential benefits of PBR but we encourage the FSRA to ease into PBR as the risks and consequences to consumers and the economy are not insignificant. The 2008 global financial crisis has been blamed by some on PBR and "light touch"

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enforcement. There are many valuable lessons to be learned from that regulatory failure. See *Principles-Based Securities Regulation in the Wake of the Global Financial Crisis*

[https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1127&context=fac\\_pubs](https://commons.allard.ubc.ca/cgi/viewcontent.cgi?article=1127&context=fac_pubs)

A FCAC review of Canadian banking industry sales practices provided an insight into the corporate culture of bank Boards and senior management. See

Backgrounder: *Domestic Bank Retail Sales Practices Review*

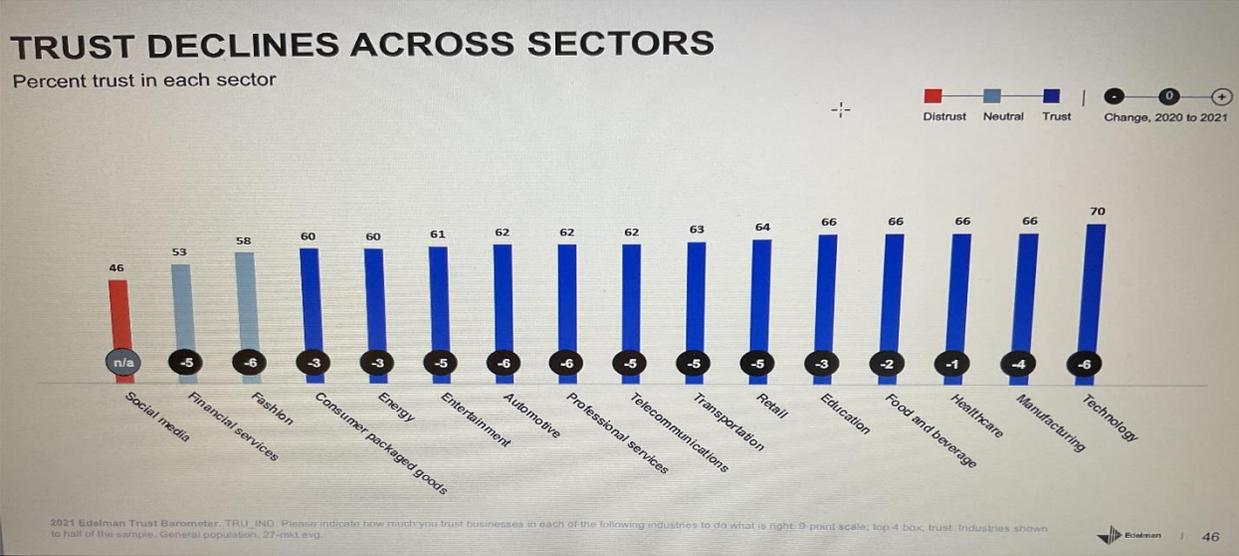
<https://www.canada.ca/en/financial-consumer-agency/news/2018/03/domestic-bank-retail-sales-practices-review-backgrounder.html>. The results suggest that the management of banks have been negligent in their oversight responsibilities as related to bank regulations and laws .To the extent that similar governance /culture shortcomings exist in the Firms that the FSRA regulates, the risks and challenges of a successful PBR roll-out and adoption will be that much greater. The FSRA would be well advised to take heed of these cautionary findings.

In the securities sector major reforms came into force in January 2022. These reforms were the product of extensive research, industry sweeps, audits and investor complaint analysis that signalled the need for major change. The client focussed reforms (CFR) are an attempt by the OSC/ CSA to improve investment industry conduct and practices. The Client Focused Reforms are based on the concept that client interests should always come first in the client-registrant relationship. The reforms are a combination of principles and prescriptive rules (e.g. use of misleading titles). The reforms will impact Firm policies, procedures and systems on compensation, conflicts-of-interests, disclosure, KYC, KYP, suitability determination and client complaint handling. We encourage the FSRA to liaise with the OSC on issues related to PBR implementation. NOTE: Soon after the CFR regulation came into effect, a number of large financial Firms took actions on proprietary products and restricted product shelves that were directly contrary to the regulatory intent of the CFR's. The OSC is investigating.

### **PBR Considerations**

It seems to us that there is insufficient empirical evidence to support the premise that PBR will work in the Canadian financial services industry. Included below are some of our concerns with a PBR approach to regulation.

- Kenmar believe that setting high standards, including professional standards, is fundamental for a regulatory system to function effectively. It is often necessary to consider more than broad principles in order to meaningfully regulate the Canadian financial services industry
- We do not believe that the existing financial services industry governance and ethical structures are sufficiently mature to justify traditional PBR. The financial services sector ranks near the bottom of the 2021 Edelman Trust barometer scale. viz



- The continued industry opposition to regulatory reform and financial consumer protection do not provide strong evidence the industry can be regulated based on a PBR framework.
- The industry has vigorously and quite successfully deflected or minimized regulatory sanctions even where clear rules exist. PBR may make it more difficult to apply enforcement actions.
- Existing industry compensation and reward structures are not consistent with PBR principles.
- The industry is in a regulatory “burden” reduction mode, not exactly conducive to developing enhanced processes and practices consistent with PBR.
- Poor industry complaint handling of consumer complaints is indicative of an industry that regards complaint handling as a means to mitigate legal exposure rather than an opportunity for process, practice or product improvement.
- Ideally, we would want to see a more developed FSRA before supporting PBR. This would include more experience and history of compliance oversight and enforcement under a PBR regime.
- Impactful sanctions and significant fines would be needed to support PBR not only to provide deterrence, but also to prevent recurrence and accommodate consumer compensation and redress.
- An independent, well-developed financial Ombudsman service with a binding decision mandate and a mandate to investigate systemic issues will be necessary to support successful implementation of PBR. The Ombudsman will provide valuable feedback information to the FSRA on how well Firms are translating principles into action at the registrant-consumer interface. Kenmar recommend that all closed cases be posted (anonymized) on the relevant ombudsman service website.

The existence of a well-funded and resourced financial consumer advisory Council to inform the FSRA of consumer needs/issues and counter influential lobbying

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organizations associated with FSRA regulated entities is an important component of a regulatory system primarily based on high level principles. A model here might be similar to the one proposed by the CSA, planned for late spring implementation.

### **On enforcement**

*"A principles-based system relies on dedicated, well-funded regulators who are interested in regulating. ... Simplifying the current thicket of rules makes sense. But it will only create more trouble if we're not willing to appoint the people—and commit the resources—needed to make the changes work. A principles-based system offers the potential for smarter regulation—the kind that helps markets work more efficiently. But the best principles in the world won't help much if those in charge aren't willing to enforce them."*- James Surowiecki, THE NEW YORKER April 29, 2008

Credible regulation, including meaningful enforcement, is crucial to PBR success. Under PBR, it may be hard to predict what would happen if an enforcement case concerning a violation of a principle alone (i.e., not accompanied by any clear rule violation) made it to the courts. This can be stressful for FSRA staff, when facing a Panel and operating under the intense scrutiny of a skillful industry defence legal team. Systems must be in place to ensure timely enforcement is not constrained due to staff fear of loss.

The nature of the enforcement regime is a critical element of PBR. Under PBR, Firms are required to think through the application of the provisions to particular situations to a far greater degree than they are with respect to a detailed rule. There is thus a greater risk that they will make the wrong assessment, i.e. one with which the regulator does not agree. They will seek to minimize this risk by calling for greater prescription from the regulator. In the absence of that prescription, the enforcement approach is critical. In a regime with a tough, punitive approach in which every infraction is met with a sanction, PBR will not succeed. It will transform into a system of detailed requirements, as that is what Firms will need. They will demand rules to provide them, and the regulator, with clear boundaries.

It is therefore imperative that fairness concerns associated with principles-based enforcement be addressed, and that a strong relationship between enforcement and policy functions be maintained. For enforcement purposes, FSRA expectations need to be communicated, explained, and justified in a regular, transparent, and understandable way. FSRA Guidance Notes, Case studies and Interpretation Bulletins provide support for PBR registrants.

### **PBR and complaint handling**

Effective complaint handling is always based on a set of core principles. The FSRA has proposed a set of principles. But principles alone are not sufficient in defining a consumer complaint handling system. Numerical timelines must be established for acknowledging a complaint and for responding to a complaint. Rules need to be established to define the minimum content of final response letters. There should be

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a prescriptive approach as to the use of Root Cause Analysis and how systemic issues are to be handled, although the information flow can vary between Firms. An external financial ombudsman service should be available with its own set of eligibility criteria, complaint handling protocols and consumer compensation constraints. Strong fairness and independence principles and generic descriptors of the complaint system by themselves will not, in our opinion, lead to optimal, consistent and high integrity consumer complaint handling.

### Conclusion

PBR invokes, not deregulation, but a re-framing of the regulatory relationship from one of directing and controlling to one based on responsibility, mutuality and trust. Regulators and regulated entities move from a directing relationship of telling and doing, to a relationship in which regulators communicate their desired outcomes and expectations clearly in principles and apply those principles predictably. Regulated entities adopt a self-reflective approach to the development of policies, processes and practices to ensure that desired outcomes are substantively met, and, critically, both trust each other to fulfil their respective side of this new regulatory bargain.

Based on what we have seen in the banking and securities industries, we question whether FSRA registrants have yet earned this level of trust. Accordingly, we urge an implementation plan that maintains key rules that may subsequently be removed once trust has been established.

When applying a PBR and outcomes-focused approach to a credit union, pension plan or insurer, FSRA says it will place greater reliance on a regulated entity's senior management and board of directors to internalize the requirements in order to achieve desired outcomes. This reliance should be based on objective evidence that the entity's governance regime is robust and representative of all stakeholder groups.

Kenmar take this opportunity to commend the FSRA on its approach to consumer engagement, consultation and regulation in general. The FSRA seems intent on building a modern, effective regulatory regime.

If we can assist on this consultation in any way, please feel free to contact us.

Permission is granted for public posting of this comment letter

Ken Kivenko, President  
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NOTE In late 2021, the OSC was criticized by the Ontario Auditor General for serious regulatory failures. See this Press release from Ontario's Auditor General *Ontario Securities Commission Inaction has Cost Investors Billions of Dollars*: [https://www.auditor.on.ca/en/content/news/21\\_newsreleases/2021\\_news\\_AR\\_OSC](https://www.auditor.on.ca/en/content/news/21_newsreleases/2021_news_AR_OSC)

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[.pdf](#) The Auditor General's Report made 26 improvement recommendations to the OSC.

### REFERENCES

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Making a success of Principles-based regulation J, Black LSE

<https://www.lse.ac.uk/law/people/academic-staff/julia-black/Documents/black5.pdf>

Forms and Paradoxes of Principles Based Regulation Julia Black LSE

*So in short, PBR has five main characteristics, all or any of which may be present in the operation of the regulatory regime. These are a purposive approach to interpretation worked out through iterated regulatory conversations; a broadly 'responsive' approach to enforcement; a focus on outcomes, a greater requirement on firms to think through the application of the stated principles, and the adoption of techniques requiring an evaluation of a Firm's internal controls.*

[WPS2008-13 Black \(lse.ac.uk\)](#)

Regulating Financial Innovation: A More Principles-Based Proposal?

[Regulating Financial Innovation: A More Principles-Based Proposal? \(core.ac.uk\)](#)

OSC Burden Reduction Initiative – Rules-based versus principle-based regulation: Osler

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