Task Force on the
Future of the
Canadian Financial
Services Sector

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Empowering Consumers

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Chapter 1

Focus of the Paper

Introduction

Consumers must be able to take advantage of a competitive marketplace and make decisions in their best interests. This background paper addresses marketplace factors which are critical for assisting or supporting consumers. These are: the transparency of transactions and disclosure; privacy of personal information; redress mechanisms; non-coercive sales practices; proficiency standards; and open markets. There is a consensus that these are significant in the marketplace of today and tomorrow, which will be characterized by ever-increasing complexity and rapid change.

To achieve a market which functions in the best interest of consumers, all players – institutions, distributors, regulators and, just as important, consumers – have responsibilities to conduct themselves in appropriate ways whether or not they are required to do so by law. It is repeatedly pointed out that markets in which consumers function well are markets which maximize benefits overall.

The Task Force's first objective has been to present a model of "best practices" upon which Canada can draw. The fundamental question the Task Force posed is: what do consumers need in order to function optimally in the marketplace? Responsibilities for consumer performance are being taken seriously in Canada today by all players as challenges are identified, proposals developed and actions taken.

The Task Force's second objective is to add to the direction and pace of this ongoing work in areas which are so critical to consumers that they should be part of the infrastructure of the system, not add-ons or decorative flourishes. This undoubtedly means that resources (not only money, but also leadership) as well as innovation and flexibility must be brought to bear on improving consumer protection. The thrust in this background paper is to set out a strategic direction, while recognizing the importance of efficient and effective implementation of the initiatives identified.

Particular attention will be paid in this paper to financial institutions (banks, trust corporations, insurance companies, credit unions and caisses populaires) and to financial intermediaries (primarily insurance brokers and agents). The securities industry and securities regulation are not a focus of this paper. This is not because the fundamental issues are less important in securities but rather because the history, context, structure and design of that industry are distinct. However, as the "pillars" of the financial services sector become less distinct, and products and services more integrated, it will become more important to focus on the principles developed in this paper as a framework for action in all areas of the sector.

The Task Force commissioned several major research studies to examine key interests of consumers. As other financial services markets function similarly to those in Canada, the Task Force was interested in whether consumer issues are the same across these markets, how these issues have been addressed internationally, and what approaches or methods are established and effective. Under the direction of Professor Robert Kerton, research studies were carried out on transparency, disclosure and redress in the United States, the United Kingdom, the European Union, the Netherlands, Denmark, Sweden, Germany and Australia. In addition, an analysis of the transparency of financial sector contracts in Canada was undertaken. The Task Force also commissioned an in-depth study of privacy protection in Canada and internationally, with the same set of objectives. These materials are a model of "best practices" upon which Canada can draw at this critical juncture in the development of the country's financial services marketplace.

The balance of this chapter discusses the rationale for focussing on retail consumers, notes the challenge for public policy in dealing with consumer protection issues, and situates the approach of the Task Force in the reality of federal and provincial powers.

Chapter 2 provides further context by reviewing recent broad market developments.

Subsequent chapters explore transparency and disclosure, privacy, tied selling, redress, proficiency standards and open markets.

Protecting the Retail Consumer

A significant rationale for every aspect of regulation in the financial sector – including prudential regulation for safety and soundness – is consumer protection. Many aspects of the sector are regulated in some way either by governments, regulators or providers in order to protect consumers and all of the Task Force recommendations are directed at consumer protection in this broad sense. The focus of this paper is consumer protection in a more limited, but by no means narrow, sense. This paper reviews means for reducing the negative impact of a type of market failure on consumers, in particular the retail consumer. This type of market failure occurs when a consumer cannot discern superior products from inferior ones.[1] This is often because the consumer does not have adequate information, or the information is not transparent, but it may also result from a range of unfair market practices. The focus on retail consumers is in line with both the historical approach and current thinking as consistently reflected in submissions to the Task Force and elsewhere. A report from Australia notes:

> Consumer protection is focused on retail markets because retail consumers of financial services often lack sufficient knowledge, experience or judgement to decide what information they need. They also require greater protection than do other users of financial services. Conversely, financially sophisticated participants in wholesale markets can reasonably be expected to attend to their own informational needs. The objective of regulating wholesale markets is therefore limited to ensuring that market infrastructure is sound and that markets are free from abuses.[2]

Rationale for Protection – Imbalances between Buyer and Seller

The basis on which consumers and financial service providers deal with each other is the contract. Contracts are "standard form contracts" carefully prepared by providers; that is, the same contract is used with every customer. A study on U.S. experiences notes:

> Conceptually, all contractual relationships are founded upon some semblance of relative equality of bargaining power between the prospective parties to the agreement. Theory envisions negotiation between provider and consumer, as to terms, as to price, as to enforcement, etc. Given the realities of consumer financial services markets in advanced economies, such as the United States, however, there exists in fact very little, if any, negotiation between buyer and seller; with rare exception, products and services are offered on a 'take it or leave it basis'.[3]

In large part, this approach stems from the underlying economics of making such products available to consumers at attractive prices. Standardization is essential to achieve economic efficiencies.[4] Further, there are wide disparities between the levels of understanding and sophistication which most consumers have of such products, as compared to vendors. Documentation and selling

[1] Robert R.Kerton, *Principles: Transparency and Redress – Essential Components of Consumer Protection Policy*, Consumers in the Financial Services Sector, Vol. 1, Chapter 1, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 13.

[2] *The Financial System Inquiry Final Report*, Australia, (March 1998), p. 14.

[3] James L. Brown, *Information Transparency and Redress – United States Experiences*, Consumers in the Financial Services Sector, Vol. 2, Chapter 2, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), Part I, p. 159.

[4] Ibid., p. 159.

practices can narrow or widen the gap between sellers and purchasers or decrease or increase the likelihood of market failure. Even if negotiations are feasible, they may be limited by lack of time, communication barriers and consumer resistance.

Since the parties – consumer and provider – generally in no meaningful way possess anything approaching equality of bargaining power, information or understanding, the potential for consumer abuse is significant, particularly given that many consumer financial services are virtual necessities to consumers. It must also be noted that consumers can be abusive of sellers. Consumer fraud is a problem for financial institutions and they must be in a position to protect themselves from it, as this also benefits other consumers.

If a consumer at any point in a transaction feels aggrieved by the actions of the provider, another aspect of inequality or imbalance is likely to exist, and that is the financial resources to pursue a legal remedy. Relatively speaking, providers have “deep pockets” of money and time compared to individual consumers. Consumers will be less able to pursue their interests to a satisfactory conclusion in the face of provider resistance.

Buyers and sellers are also distinguished by another type of imbalance: that of public voice. Consumers are a much more diverse and dispersed group as compared to other players (institutions, intermediaries, regulators, policy makers). Obtaining consumer experiences, perspectives and recommendations is much more difficult than obtaining the same from industry or even government. Research indicates that consumers do not voice all their consumer problems as complaints, and there are relatively few other methods for consumers to assert themselves.[5] Also, the consumer voice is sometimes appropriated by those dealing with consumers in transactions (e.g., institutions and intermediaries), who attempt to give the perspective of the consumer. Business, in particular, has useful perspectives to bring to bear on markets, market failures and options, but business does not speak for the consumer. Business ultimately is seeking to maximize its economic interest, as is the consumer; the two interests intersect but are not identical.

Perspective on Benefits and Costs – The Challenge for Public Policy

Typically – again as seen in the submissions to the Task Force – consumers support more rigorous consumer protection initiatives, focussing on the benefits, and providers support more selective initiatives, focussing on the cost. In the-

[5] Robert R. Kerton, *Policy: The Consumer in the Future of Canada’s Financial Services Sector*, Consumers in the Financial Services Sector, Vol. 1, Chapter 2, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 239.

ory, both consumers and providers can benefit from mechanisms which reduce market failure and which are designed to be efficient and effective in cost terms. Businesses which take their consumers seriously are more competitive. There is a tendency for the benefits and costs to suppliers, distributors and even governments, however, to be more apparent than those for consumers, and therefore for the costs to business to be more persuasive than the benefits to consumers.

Public policy must strive to identify the benefits and costs in terms of the efficient functioning of markets, rather than the narrower interests of any of the participants.

Consumer Protection Legislation and Regulation – Federal and Provincial Powers

Neither the federal nor the provincial level of government is clearly assigned exclusive responsibility for all aspects of financial institutions, the financial marketplace or the financial services sector. Only one type of financial institution, product or service – banking – is specifically designated to be within exclusive federal jurisdiction, and the scope of that power has not been exhaustively determined by the courts. For the other types of institutions and services, and for the marketplace more broadly, the allocation of governmental authority is less clear.

Federal and provincial governments each have the power to incorporate trust and insurance companies. Only provinces incorporate credit unions and caisses populaires. Historically, the provinces have regulated the market conduct of institutions, as well as all intermediaries, because the gaps in federal power are covered by the broad provincial power over property and civil rights which includes the law of contract. However, the federal government also regulates some aspects of market conduct for federal institutions through its power to incorporate. As a practical matter, business is regulated through both corporate law and contract or market conduct regulation, and so there is overlap between the two levels of government in the case of trust and insurance companies, and possibly in the case of banks.

Governments often take action, or refrain from taking action, in ways that arguably are not consistent with their underlying jurisdiction. Institutions do the same thing. Banks, for instance, comply with a number of pieces of provincial legislation in conducting the business of banking (e.g., mortgages, trusts and securities).

It is clear that both the federal and provincial levels of government have jurisdiction of considerable scope in the sector, whatever the certainties or uncertainties of that jurisdiction overall or in any set of circumstances.

As a result, the current situation is that:

- the federal government regulates the consumer protection aspects of banks and banking;
- the federal government regulates some consumer protection aspects of other federally incorporated financial institutions (trust and insurance companies) through its power to incorporate these institutions;
- provincial governments regulate the standards of competence and behaviour of financial intermediaries (e.g., insurance brokers and agents, securities dealers, mortgage brokers, financial planners); and
- provincial governments regulate the sale and content of financial contracts of trust and insurance companies, as well as credit unions and caisses populaires, and some provinces also state or assert that their regulation of the financial service marketplace applies to the banks.

The Task Force notes that, apart from the underlying constitutional jurisdiction in respect of consumer protection, it is often not clear where responsibility and accountability for consumer protection in financial services rest within a government. The Task Force believes that this important gap should be eliminated. The Task Force notes elsewhere that the statutory mandate of the Office of the Superintendent of Financial Institutions (OSFI) should expressly include OSFI's role with respect to consumer protection.[6] The Task Force also urges that provinces clearly identify, in cases where they have not already done so, which government ministry or agency has responsibility and accountability for consumer protection.

The Task Force's conclusions on the model of best practices are intended to reflect and fit within the current constitutional framework. In other words, such conclusions are intended to be applicable to, and implemented in the case of, banks and other federal financial institutions to the full extent of federal jurisdiction. They are also intended to be applicable to, and implemented in respect of, financial institutions and intermediaries regulated by the provinces. There is no evidence that the fundamental interests and needs of consumers vary from jurisdiction to jurisdiction. Further, the Task Force reinforces and supports the voices of many others who urge the federal and provincial governments to make harmonization a priority, using the foundation of best practices, and making progress whenever and however possible.

[6] Background Paper #5, *Improving the Regulatory Framework*.

Chapter 2

Scan of the Environment

Marketplace in Evolution

The financial services marketplace is always in evolution, although the trends and pace can vary enormously. There is a broad consensus that we are in a period of great and rapid change that will continue into the foreseeable future.

As discussed in other background papers,[7] change is leading to new and more varied product offerings and additional ways of accessing suppliers. Functions of existing institutions are converging, new competitors are entering markets and, even as existing players consolidate within and between traditional "pillars" of the sector, choices are increasing for consumers. These broader choices are being driven, increasingly, by technology as an enabler of both product design and new channels of delivery. This is the opportunity side of the ledger.

On the risk side of the ledger, although technology makes more resources available to consumers, not all consumers can benefit from these choices. As with any process of rapid change, a transition time is required before consumers become comfortable with new ways of doing things, and through the transition many will feel inconvenienced and less well-served than before. Moreover, risk levels experienced by all consumers may well be increasing, simply because of the increased complexity and variety of product offerings. The challenge of making purchases appropriate to individual circumstances has increased. Given concurrent changes in public policy on income support of all kinds, including retirement income, the appropriateness and effectiveness of the financial decisions made by individual consumers have significance, in the aggregate, for society as a whole.

Although some financial services and products are more like commodities than others, it cannot be ignored that buying a financial service or product is different from most of our other buying decisions. Financial products and services, including financial advice, are:

- typically complex and intangible;
- usually purchased on an infrequent or even a once-only basis, so that the experience in assessing quality is limited;

[7] See, for example, Background Paper #1, *Competition, Competitiveness and the Public Interest*.

- difficult to compare, so that shopping around is inhibited;
- subject to factors, including penalties, that make moving business costly; and
- prone to regular and rapid modification.[8]

Further, some contracts are for longer terms, with the risk and return changing as economic conditions change, introducing uncertainty into whether to purchase, or whether to maintain, the arrangement.[9]

As a result, the nature of the product can make the benefits to consumers in open and competitive markets more difficult to realize.

Every financial institution, and every intermediary, is now in the sales business. Although there may have been a time when financial institutions simply undertook account transactions or underwrote insurance policies which others sold, those days are gone. Emphasis is now placed on the "total customer relationship" which, from a provider's perspective, entails cross-selling products to maximize the share of the consumer's wallet. This emphasis is supported by incentives and compensation schemes designed to encourage sales.

The dynamics in the relationship between institution and consumer, and between intermediary and consumer, have changed more than they have stayed the same, and the combination of product and sales changes produces a much more challenging marketplace for consumers. Most of the advice available to consumers comes from either the manufacturers (financial institutions) or the distributors (financial intermediaries) of the product, rather than from advisers who are truly independent and make no financial gain from any sale.

Marketplace Regulation

Marketplaces evolve faster than public policy and regulatory instruments. This is certainly true of the financial services sector, and the gap may be greater in financial services than in some other sectors. First, the sheer amount of regulation is greater than in most other sectors. Second, much of the regulation is driven by statute, statutory instruments and regulators with limited amounts of discretion. This also may be particularly true of consumer protection in the sector. In most of the country, the consumer protection structure and measures in place are much the same as they have been for decades. Furthermore, there has been limited market conduct regulation of deposit-takers (banks, trust companies, credit unions and caisses populaires), a vacuum more keenly experienced now that they too are so clearly in the sales business.

8 The Australian Consumers' Association, Submission to The Financial System Inquiry (September 1996), p. 7.

9 Ibid.

Competition undoubtedly brings benefits to consumers. Competition, however, is not a consumer protection panacea. If consumers are to reap benefits from competition, they must search for, and be able to select, the best package, based on characteristics and costs, for them. If characteristics and costs in competing products cannot be identified, or if they are presented in an inaccurate or misleading way in either written form or through sales techniques, or if products defy comparison, then the consumer is disadvantaged.

Similarly, regulation is not a guarantee of successful results for consumers in the marketplace. Industry players in the sector are responsible for how they treat their customers overall, as regulation will touch only some aspects of the buyer-seller relationship. Consumers are responsible for active and informed participation in the marketplace.

The Task Force has heard about significant gaps in consumer protection, principally relating to the need to increase the transparency of the marketplace through enhanced disclosure; to provide appropriate avenues for redress; to strengthen privacy protection; and to address tied selling. The Task Force has also heard concerns about the proficiency of intermediaries and the degree to which access to provincial markets is restricted by licensing regimes. The Task Force has not heard in the submissions that current consumer protection measures are unnecessary or fundamentally flawed, apart from the real challenges posed by overlap, duplication and lack of harmonization, which arise primarily from Canada's constitutional structure, as well as from institutionally based regulation in an increasingly functional marketplace.

The federal and provincial legislation governing financial institutions has been updated in recent years and has created or responded to the dismantling of the four "pillars" by changes in corporate powers, including networking. Overall, consumer protection legislation has been slower to change to reflect the new environment. On the one hand, the system may be ripe for change. On the other hand, the degree of change required may be a very real challenge to acceptance and implementation.

Stakeholders

Although consumer protection is of significant concern to all key stakeholders (consumers, institutions, intermediaries, trade associations, regulators, and governments), there is no consensus on either the need for change or best practices. In the view of providers (the more frequently heard voice), the need is not proven, over-regulation is a serious issue, the cost is not justified and self-regulation is and will be sufficient. In the view of consumers, purchasers are picking up the substantial costs of market failure occurring because of regulatory failure, and significant new statutory measures are needed. Views are strongly held, emotional and volatile, based on a mix of analysis, assumptions, assertions and anecdotal evidence. How something is perceived can be more powerful than how it actually works, and this observation applies to all stakeholders.

Chapter 3

Transparency and Disclosure

Introduction

The Canadian financial services marketplace is characterized by an explosion of products which are rapidly changing. Further, it is a market shopped not by experts but instead by consumers making infrequent purchases.

This is a market where consumers must search for offerings with the quality-price combination which best meets their needs. Price is typically not a reliable indicator of quality. Kerton describes the Canadian financial services marketplace as a "noisy" one. There is product and promotional proliferation by sellers, with similar services selling for very different prices both within and across sellers (this is particularly true for life insurance, auto insurance, credit cards and mutual funds).[10]

As will be established in detail in this chapter, there are real limitations for consumers on the clarity – the transparency – of the quality, terms and prices of products and services. Search costs for consumers are high. Even if a consumer can identify his or her needs and find a suitable type of product or service, the consumer will be challenged to find the one with the best quality-price combination.

Transparency relies upon disclosure made by the seller, among other things, but it is a different and broader concept:

> Transparency, according to the Oxford Dictionary is defined as 'manifest, obvious, clear ... open.' It is clear to the viewer. In contrast, disclosure is under the control of the party doing the disclosure. It is possible to obey a law on disclosure in a manner that raises the time cost of the consumer to a high level.[11]

A number of factors are important in creating transparency for the consumer: the timing of the receipt of needed information; the content and format of that information; the presentation of the information; and the timing, content, format and presentation of information on comparable products and services.

10 Robert R. Kerton. "Principles of Transparency and Redress as Components of Consumer Protection Policy," p. 10.

11 Ibid.

Brown observes that transparency, like other key consumer protection measures, offers benefits for both sellers and buyers:

- individual consumers will be provided with information armed with which they can then maximize their own self-interests in selecting optimally appropriate products or services (this represents micro-economic consumer protection); and
- markets will operate more efficiently by rewarding providers of products or services with greater appeal or attraction to consumers (this represents macro-economic consumer protection).[12]

Transparency is an investment in consumers. It will not eliminate all the marketplace challenges faced by them. It will not eliminate the need for them to be active, questioning and vigilant. It will assist consumers to be confident and informed.

This chapter surveys the level of transparency in the Canadian financial services marketplace today, and indicates directions for positive change.

Consumer Assessment of Transparency

Out of the results of the 1997 National Quality Institute (NQI) survey, which was based on 10,333 responses, two assessments by consumers are of interest.[13] Of the 21 sectors covered, 6 were in the financial services sector (credit unions, auto insurance, trust companies, insurance, banks and real estate agents). Respondents rated credit unions, auto insurance and trust companies in the top half of the rankings (3, 7 and 9 respectively, out of 21) for overall service quality. Insurance, banks and real estate agents (15, 16 and 17 respectively, out of 21) were in the bottom half. When asked whether respondents have received information about a product or service that is clear and complete enough to enable the respondent to make a smart business decision, the rankings for the same six were almost identical to those for overall service quality.

It should also be noted that English-speaking consumers of financial services report experiences that are decidedly more negative than those reported by French-speaking respondents.

Quantitative and Qualitative Assessment of Transparency

The nature of and need for transparency (particularly the use of plain language in promotional and contractual documents) have to some degree been understood, acknowledged and acted upon in the financial services sector for some

[12] James Brown, op. cit., p.161. See also, Kerton, op. cit., pp. 15, 16.

[13] Robert R. Kerton, *The Consumer in the Future of Canada's Financial Services Sector*, pp. 214, 217.

years. Sellers have had incentives to make changes and improvements. As corporate citizens, they have responded to a change in public demand or desire. Sellers with good offerings also have an economic interest in transparency. They gain market share whenever consumers can detect the superiority of their products or services. In a noisy market with limited ground rules, however, sellers may not see their investment in transparency paying off, and so they follow average marketplace practices.

The Task Force commissioned an objective study of the degree to which contract documentation in use with consumers today is comprehensible to a large audience.[14] It is appropriate to focus on contracts or agreements, for the following reason:

> ... any relationship between a consumer and a provider of financial services is ultimately founded upon contractually imposed duties on the part of both the consumer – typically, to pay the fee or charge according to the contract governing the relationship – and the institution – for example, to make the payment, to provide the insurance coverage, the securities services, the credit, etc. sought by the consumer.[15]

How well do Canadians read? The International Adult Literacy Survey (IALS), conducted in 1994, measured literacy utilizing three different types of documents: prose (newspapers, books and manuals); documents (forms, tables and graphs); and quantitative (arithmetic material). Skills relating to one or more of these scales are required to read most financial agreements. Although there were slight variations among the types of documents, about a quarter of the Canadian population can read simple documents (Level 1), and a fifth can read complex documents (Level 4/5). The remaining respondents (approximately 55 to 60 percent) are in two middle categories (Levels 2 and 3). Participants taking the IALS test in French scored well above national scores for Level 1 and well below for Level 4/5. Canada's results are more comparable to the United States than to those of European countries where typically there are higher percentages in Levels 2 or 3. These results suggest that even though two thirds of Canada's population have completed high school, only a small percentage are likely to possess the literacy skills that would allow them to understand complex documents on financial topics.[16]

The Colbert study measured communication transparency (specifically, readability and comprehensibility) of 49 English-language contracts of various

[14] Judith Colbert, Hélène Carty, and Paul Beam, *Practice: Assessing Financial Documents for Readability*, Consumers in the Financial Services Sector, Vol. 1, Chapter 2, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998).

[15] Brown, op. cit., p. 159.

[16] Colbert, op. cit., pp. 61, 62 (Part I) and pp. 108, 109 (Part II).

types collected from a variety of financial services sellers.[17] Similarly, 21 French-language contracts were analysed.[18] The results, described in detail below, are striking.

The contracts used in the Colbert study represent a fair sample, being drawn from a range of well-known organizations with significant market share relative to their industry or locale.

With respect to readability of the contracts written in English, which is measured quantitatively, the study concluded that "almost without exception, the documents are difficult and complex and require a college/university level of comprehension."[19] With respect to comprehensibility, which is measured qualitatively, there is "a great gap between the characteristics of the documents and the capacity of their audience to understand them. This suggests that the purpose of such documents is disclosure in response to regulatory requirements, rather than genuine communication with consumers."[20]

In the case of contracts written in French, the documents in all categories in the study were in the difficult range.[21]

In addition, the study identified other issues that have a direct impact on transparency. Access to documents is a serious problem. One type of document – credit card agreements – was not available at all in branch offices as these are sent directly to consumers who have submitted signed credit card applications. Use of the card may constitute acceptance of the agreement. Life insurance contracts were also difficult to obtain. Overall, for both the French and English contracts, the authors found:

> ... many of these documents are unavailable to average consumers in advance of completing a transaction. Consumers without a personal contact within an institution or who must cope with barriers such as age, disability or unfamiliarity with language have an even greater disadvantage. Access appears to be the first and perhaps most important transparency issue.[22]

In addition, computer-generated and on-line documents are becoming the norm and print versions are becoming less available:

[17] Selected from a range of sellers, the contracts were of the following types: standard auto lease agreement; basic banking agreement, debit card agreement; credit card application; loan application and agreement; auto insurance policy; life insurance policy; and mutual fund prospectus. See Colbert, op. cit., Appendix I.1 for the list.

[18] The French language contracts were of the following types: standard auto leasing agreement, basic banking agreement, debit card agreement, credit card application, life insurance policy and mutual fund prospectus. See Colbert, op. cit., Appendix II.1 for the list.

[19] Colbert, op. cit., p. 98.

[20] Ibid., p. 58.

[21] Ibid., p. 109.

[22] Ibid., p. 50.

> ... local staff, in particular, appear to be unable to use the computer to generate a generic sample for inspection. While a convenience for institutions, computer-generated documents appear to make information more difficult for consumers to access information. Institutions are also turning to the Internet to provide on line services ... Defining and identifying transparency in on line agreements may be the most urgent problem facing the sector.[23]

Marketing information is readily available. Sometimes it is combined with a legal document, and sometimes it is made to look like a legal document. Agreements often consist of multiple documents, which may or may not be integrated in a clear and accessible way. In many cases, reliance is placed on agents, brokers or employees to explain the documents:

> In many cases, therefore, the extent and quality of information available to consumers largely depends on the expertise of staff, rather than on the contents of specific documents. This reliance on staff is particularly troubling since staff may be unaware of particular details or uninterested in providing the information consumers need to make wise decisions.[24]

The content of agreements may be influenced by two external factors: language relating to a legal precedent which the seller wants to invoke or exclude, and language prescribed by statute or regulation. In the case of the former, sellers are often reluctant to deviate from the actual language of the precedent. In the case of the latter, the relevant government or regulator may not have taken plain language into account in fixing the requirement.

Looking at the results in more detail is useful. Readability is a text-based measure of difficulty which looks at the complexity of words, the length of sentences and paragraphs, and the percentage of verbs in the passive voice. For the contracts written in English, the study used three different established indices (Fog Index, Flesch Readability score and Flesch-Kincaid Index).[25] In the Flesch-Kincaid Index, good business writing ranges from the level of grades 6 to 10. A higher score (e.g., over grade 13) does not necessarily mean that the document is appropriate for that grade level, but instead indicates that the writing is complex and difficult to read. Only 5 of the 49 assessed English-language samples scored 12 or below, meaning that 89 percent were beyond the high school level.[26]

Two important measures of readability are the percentage of verbs in the passive voice and the average sentence length in words. Looking at English-language documents, a "complex" auto lease had 33 percent of its verbs in the

[23] Ibid., p. 51.

[24] Ibid., p. 51.

[25] Ibid., Appendix I.2.

[26] Ibid., p. 58.

passive voice, and an average sentence length (ASL) of 70 words[27]; a "standard" one had 18 percent passive verbs and an ASL of 21.[28] A "complex" mutual fund prospectus did not use any passive verbs, but had an ASL of 63.[29] A "good" mutual fund prospectus had 16 percent passive verbs and an ASL of 20.[30] Interestingly, during the time of the study, the "complex" mutual fund prospectus was revised by its issuers and was rated as "good;" it went from being one of the least readable to the most readable document in the study.[31]

Comprehensibility is measured using more subjective criteria, such as audience awareness, language, presentation, contextual factors, intent, legal requirements, industry requirements and meaning. These factors can increase or decrease readability. When qualitative review was applied to the mutual fund prospectuses, it was noted that the qualitative factors did not save documents which presented problems in readability.[32]

In the case of contracts presented in French, two of the text-based measures of readability were considered appropriate (Flesch Readability and Flesch-Kincaid). All French-language documents exceeded desirable ranges, although the mutual fund documents were not as complex as the others.[33]

Overall, Colbert concludes:

> In general, results indicate that there is little difference in scores between the Canadian English- and French-language documents included in this study. Although the mean Flesch readability scores for English documents were higher, all – with the exception of the French-language mutual fund prospectuses – were below 50. On the Flesch-Kincaid scale those documents require a mean Grade level of 13.3, also the lowest rating among the Canadian categories. Otherwise, grade levels are clustered from 15 to 24, deep in the **Complex** range. Isolated documents in both languages produced scores within the **Standard** range, some with a corresponding improvement in Flesch-Kincaid Grade Level. Without question, these scores indicate that the documents demand well-developed literacy skills and are likely to challenge most readers.[34]

Information available to the Task Force on consumer complaints and the circumstances in which redress is sought offers practical confirmation of the results of the Colbert study. Contractual or legal issues predominate, as illustrated in

27 Colbert, op. cit., Statistical Summary I.1, Document B, p. 37.

28 Ibid., Statistical Summary I.1, Document C, p. 37.

29 Ibid., Statistical Summary I.4, Document B, p. 44. See also Table I.2 (qualitative analysis).

30 Ibid., Statistical Summary I.4, Document F, p. 44. See also Table I.3 (qualitative analysis).

31 Ibid., p. 175 and Table IV.8.

32 Ibid., pp. 66, 67, Tables I.2 to I.4.

33 Ibid., p. 103 Part II and Table II.1.

34 Ibid., p. 176.

Chapter 6. Lack of transparency is a major contributor to problems in the relationship between purchasers and sellers.

The study noted an absence of legalese,[35] which may indicate the result of the first generation of change in documents which sellers have undertaken in the last decade. The study clearly establishes the need and the urgency to take further steps to improve the transparency of consumer agreements through changes to timing of delivery, plain language (to assist readability), and form and presentation (to assist comprehensibility). This is a significant challenge whether we look across the marketplace or at a particular type of document. In the preface to the study, Professor Paul Beam notes:

> There is no 'template' or form to assure effective documentation by the mere adherence to a simple set of rules. Language options and the complexity of many products make this a naive hope. Plain Language documents can be demonstrated to be effective under usability test conditions, but they have to be created by informed writers who wish to help motivated readers understand their products and service. There is no short cut to writing well-structured, informed documentation.
>
> 'Plain Language' is a concept of the marketplace, not of the research laboratory or classroom. Its principles are supposed to standardize descriptions of services, processes and products. The concept is based on these general premises:
>
> 1. Concepts can be expressed in language that the general public can understand in all areas of commerce requiring individuals' informed consent;
> 2. Tests of vocabulary and sentence length and complexity performed on an organization's public information reliably predict reader comprehension according to readers' education levels; and
> 3. Public documents require both objective testing and the consideration of experienced writers. There is no formula that permits inexperienced writers to create clear, comprehensible documentation from a 'writing guide' or rules applied by rote… .
>
> Only comprehensive editing by trained experts, from consistent principles, applied to all public expressions of an organization, can implement Plain Language and only sustained training of writers can assure its development from the initial author through the writing department to marketing and standards. This is a hard answer. It means companies must spend more than they wish at each stage of the process and even more on sustained testing to assure results. It probably accounts for the sporadic and minimal effects Plain Language has enjoyed over the past twenty years.[36]

[35] Ibid., p. 63.

[36] Ibid., pp. 33, 34.

Statutory or regulatory provisions governing transparency are rare in Canada. One example is the duty to use Plain Language included in the Financial Consumers Act (Alberta).[37] Readability and comprehensibility standards, however, have not been established by statute or by regulatory practice. In some cases, as noted by Colbert, a government itself prescribes contract language which is neither readable nor comprehensible. The most obvious example is the case of automobile insurance policies.[38] Some industry associations encourage the use of plain language in contracts and consumer communications.[39]

The next section of this chapter will focus on use of, and experience with, means of promoting market transparency.

Promotion of Market Transparency Internationally

It is obvious that transparency cannot be improved to meet an adequate standard unless sellers understand the need, accept the challenge and put resources into improvements. Sellers, however, are reluctant to proceed to invest in transparency unless they have confidence that all sellers are moving to meet the same standard and unless they have sufficient incentive to overcome economic incentives pushing the other way. Brown notes:

> ... given the mass nature of consumer markets, experience has shown that market forces will generally not act adequately to ensure that comprehensible, timely information will be broadly available to consumers to such end.
>
> While to some extent, one might expect vendors to provide good, complete, timely information in order to attract consumers to purchase from them, these same vendors are also impelled to provide such information that most effectively attracts consumers **regardless** of its objectivity, accuracy, or even basic fairness. That is to say, absent controls, vendors of products or services have obvious incentives to provide self-serving or otherwise unhelpful information simply to 'make the sale.' Some, sad to say, have been unable to resist such temptations. Thus, it may not be (indeed, experience shows it almost certainly is not) safe – if consumers are to be protected adequately – solely to rely upon vendors to provide adequate information.[40]

As we look first at the current situation in other countries, it will indeed be notable that governments are involved in the promotion of market transparency, through leadership, through joint efforts with industry and con-

[37] Financial Consumers Act, S.A., c. F-9.5, s. 13(1) which was proclaimed in force May 1, 1992. All references to statutes and regulations in this Chapter refer to the provisions as amended to date of publication of this paper.

[38] For example, Colbert, op. cit., Appendix I.3 re: Insurance Documents – Auto Insurance.

[39] Canadian Life and Health Insurance Association, "Canada's Life and Health Insurance Industry: The Regulatory Environment", Submission to the Task Force, Vol. 1, p. 13.

[40] Brown, op. cit., p. 160.

sumers, and through standards-setting in legislation or other forms of regulatory instruments.

United States

Transparency has been a focus of American public policy for many decades. Both detailed disclosure laws and regulatory guidelines are in use. Several pieces of federal legislation establish detailed disclosure regimes. These include the Truth in Lending Act[41] (consumer credit and credit cards), the Electronic Fund Transfer Act[42] (debit cards) and, the Truth in Savings Act[43] (savings accounts).

The statutes mandate a range of information practices. These include the timing of the provision of information, such as:

- during general information searches, e.g., in advertising and promotional pieces;
- during contract formation, e.g., on the note or other document evidencing the binding legal obligation between the parties;
- during the ongoing relationship, such as on periodic billing statements in credit arrangements, or when filing a claim under an insurance agreement; and
- when inquiries or disputes arise, regarding substantive claims, for example, or procedural rights involving the processing of such inquiries or disputes.[44]

They may also govern key elements of content and format, such as:

- highlighting the most critical terms or elements of the service in disclosure documents or in underlying evidentiary agreements;
- use of examples of how future contingencies might affect consumer obligations, for example, regarding interest rate changes in credit agreements, market value fluctuations in securities contracts, etc.; and
- the desirability of providing information on past performance histories of the vendor, for example, regarding mutual fund accounts.[45]

Finally, they may address readability and comprehensibility through Plain Language requirements and other means.

An example of regulatory leadership is the Model Readability Act, for property-casualty (P&C) insurance, drawn up in 1981 by the National Association of Insurance Commissioners in the United States. It consists of a model act and

41 15 U.S.C. 1601.

42 15 U.S.C. 1693.

43 12 U.S.C. 4301.

44 Brown, op. cit., p. 162.

45 Ibid., p. 162.

regulations. It has been introduced as legislation in a number of states and otherwise applies as a regulatory guideline or voluntary code.

As its title suggests, the code focusses on readability by establishing minimum language and format standards as follows:

- use of simple sentence structure and short sentences;
- use of commonly understood words;
- avoidance of technical legal terms wherever possible;
- minimal reference to other sections or provisions of the policy;
- organization of the text; and
- legibility.

The regulation provides greater delineation of the standards, including the following:

- generally the policy shall be printed in not less than 10-point type;
- there must be an adequate contrast between ink and paper; and
- captions, headings, and spacing shall be used to increase overall legibility.

Colbert also analysed for readability the samples of U.S. contracts collected and reviewed by Brown. Documents were to be measured for readability under the Flesch Readability test. A score of 40 or above is acceptable (higher scores mean greater readability, and 60 to 100 is considered desirable).[46]

Banking and mutual fund documents were found to be Complex, Fairly Difficult or Difficult to read and requiring a college- or university- level education. Insurance documents (only home insurance policies were included in the Brown sample) were found to be Good, on the cusp of standard reading difficulty and just exceeding the high school education level.[47] The lowest mean score among U.S. documents was 44 (in contrast to 25 for Canadian English-language documents), suggesting that legislation described above may have had an effect.

By way of comparison, the Canadian contracts reviewed in the Colbert study had Flesch scores of Difficult or Very Difficult – that is, scores below 50.[48] It is worth noting that American consumers face some of the same problems of access to documents as Canadians, particularly with respect to credit card agreements, which are commonly not available until after approval of the application.[49]

[46] Colbert, op. cit., Appendices, p. 76.

[47] Ibid., p. 138.

[48] Ibid., p. 85.

[49] Brown, op.cit., p. 169.

As is common with federal legislation in the United States, the provisions of these acts may be enforced privately through actual damages, statutory penalties and attorney fees, together with court costs. Thus, the penalties for non-compliance may be significant. These potential penalties are one of the factors which have led to the drafting of model forms by the federal regulator. Brown states:

> As the complexity and variety of such products have expanded, the rate and degree of compliance with the spirit of such statutes has been, to say the least, uneven. Further, the compliance costs to vendors have been significant. Accordingly, the Federal Reserve Board, as the statutory administrative agency assigned by the Congress under the Federal Consumer Credit Protection Act, has promulgated a wealth of model forms dealing with various types of common consumer financial services and products. These forms are intended to be usable by a financial services provider, and as a result, to provide a 'safe harbour' from the statutory penalties provided for in the underlying statutes. They have been developed and designed both to comply with the specific requirements of the various statutes and their implementing regulations, and to provide meaningful information to consumers about the relevant subject matters so as to promote market transparency. Significant efforts have been made by the Federal Reserve in developing such forms to solicit input from industry, from consumer representatives, from educators, and others.[50]

European Union

In 1993, the founding document for the European Union (EU), the Treaty on European Union or the Maastricht Treaty, included a requirement for the EU to make "a contribution to the strengthening of consumer protection".[51] It also states, "The Community shall contribute to the attainment of a high level of consumer protection through ... measures adopted ... in the context of completion of the internal market."[52] Mitchell notes that the drive in the EU has been toward a single market:

> With a few exceptions, the panoply of Directives that have been adopted has been aimed primarily at creating freedom for financial services organizations to compete throughout the EU and has not had the consumer's interest as an explicit and central preoccupation.[53]

At the same time as a number of single market directives which contain some consumer information provisions were being translated into national law, the

[50] Ibid., p. 174.

[51] Jeremy Mitchell, *Financial Services and Consumer Protection: Policy and Practice in the European Union and in some EU States, Part I: European Union – Policy and Practice*, Consumers in the Financial Services Sector, Vol. 2, Chapter 1, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 19.

[52] Ibid.

[53] Ibid., p. 18.

European Commission issued a consultation paper in 1996 on consumer aspects of the marketing of financial services. Mitchell observes:

> Reaction from the consumer side to the Green Paper was generally positive, though urging the European Commission to develop a comprehensive consumer protection strategy and to range wider and deeper in its analysis of specific consumer problems. Examples given were the need for a systematic strategy covering consumers' information needs, control of self-interested financial advice and [unfair selling], continuing problems with payment cards and the absence of effective dispute resolution schemes which would have powers to deal with cross-border complaints and to secure redress for consumers when complaints were justified.[54]

The European Commission's conclusion to the consultation process was to favour, as industry had suggested, "as much a change of attitude ... as a targeted programme of legislation."[55] It considered that other means, "notably a dialogue between industry and consumers," were more suitable for improving information, market transparency and resolving consumer problems and complaints.[56] It is not clear how likely it is that EU-wide agreements will be developed or implemented on a timely basis.

Consumer credit was the first financial service to be the subject of specific EU legislation. The Consumer Credit Directives contain some specific information provisions. They must be read against the more general 1993 Unfair Contract Terms Directive, which states:

> In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail.[57]

The Third Insurance Directives also have consumer information rules that, in the case of life insurance, are much more extensive. Although there is no binding directive concerning payment cards and electronic money, there is a Recommendation, the terms of which must be complied with by December 31, 1998. The Recommendation states that the issuer of an electronic payment instrument should "draw up a written contract written in Plain Language and in readily comprehensible form." It goes on to list specific items required to be disclosed.[58]

[54] Mitchell, op. cit., p. 19, 20.

[55] Ibid., p. 20.

[56] Ibid., p. 20

[57] Ibid., p. 31.

[58] Ibid., p. 28.

On the European agenda for the future are a number of issues relating to financial intermediaries, including their role in information disclosure.

United Kingdom, Netherlands, Denmark and Sweden

The United Kingdom, the Netherlands, Denmark and Sweden have tended to govern industry behaviour through instruments developed on a consultative basis, although there are some significant differences in the way these instruments are developed and in their legal status.

In the United Kingdom, leaving aside the regulation of securities, there is both a Banking Code and a Mortgage Code. Both are designed to encourage standards of best practice of fair trade with customers, and both include high-level commitments to information disclosure. Both are monitored and reviewed by the Independent Review Body for the Banking and Mortgage Codes. It can consider complaints but does not have the power to apply sanctions.[59]

The Netherlands has a well-developed, ongoing forum for dialogue and initiatives in the Committee for Consumer Affairs (CCA) within the Social and Economic Council. The Committee's role in negotiating standard clauses for consumer contracts has recently moved to the Coordination Group Self-Regulation Dialogue. Joop Koopman notes:

> This institution offers a framework for the dialogue (negotiations) between consumer organizations and organizations of entrepreneurs in sectors of industry on their standard clauses for consumer contracts. These negotiations are conducted in ad-hoc consultation groups which are chaired by an independent member and supported by the CCA secretariat. These negotiations take place under the guidance of a so-called *Protocol for consultation on general clauses* which has been drawn up by this Co-ordination group.[60]

Standard clauses have been developed for banks which apply to all bank customers. Consumer credit is regulated through the Dutch Consumer Credit Act, which is based on, but goes beyond, the relevant EU Directive. Mortgage lending is governed by a code of conduct, developed with consumer input, as the industry opposes its inclusion in the consumer credit legislation.

In Denmark, the Consumer Ombudsman (a regulatory entity, not a forum for individual complaints and redress) administers the Marketing Practices Act,

[59] Jeremy Mitchell, *Financial Services and Consumer Protection: Policy and Practice in the European Union and in some EU States, Part V: United Kingdom,* Consumers in the Financial Services Sector, Vol. 2, Chapter 1, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), pp. 136-139.

[60] Joop Koopman, *Financial Services and Consumer Protection: Policy and Practice in the European Union and in some EU States, Part II: The Netherlands,* Consumers in the Financial Services Sector, Vol. 2, Chapter 1, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 56.

the Payment Cards Act, and the Price Marking and Price Display Act. These legislative provisions, which include disclosure, are now being augmented by "soft laws" or ethical standards which are developed by the interested parties and issued as guidelines of the regulator.[61] To date, they have been issued for banks and payment cards. In Sweden, which also has numerous statutory provisions, the emphasis is on active problem solving between the market regulator and industry.[62]

Australia

In Australia, the Wallis Inquiry favoured a greater reliance on disclosure than other forms of market conduct regulation, with a shift to more useful disclosure, greater uniformity and more use of positive duties (as opposed to broad prohibitions). In order to facilitate comparison between products, the Inquiry recommended that disclosure codes should be made more consistent and information should:

- be comprehensible and sufficient to enable a consumer to make an informed decision relating to the financial product;
- be consistent with that for similar products regardless of which institution offers them; and
- appropriately disclose remuneration or commissions paid to advisers.[63]

Further, the Wallis Inquiry encouraged the use of short "profile" statements for more effective disclosure. These would contain:

- a brief description of the characteristics of the product;
- a clear and unambiguous statement of the risks involved and a clear and unambiguous statement of applicable fees, commissions and charges in a form which enables comparison with similar products; and
- such other disclosures as the regulator considers appropriate.[64]

One of the more innovative outcomes of the Wallis Inquiry is a recognition of the value of user testing and a commitment to integrate it into measuring the effectiveness of the overall approach and industry performance. The emphasis

[61] Suzanne Storm, *Financial Services and Consumer Protection: Policy and Practice in the European Union and in some EU States, Part IV: Denmark and Sweden*, Consumers in the Financial Services Sector, Vol. 2, Chapter 1, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p.103.

[62] Ibid., p. 113.

[63] Wallis Inquiry Recommendation 8, quoted in Robert Kell, *Reform of Consumer Protection in the Australian Finance Sector*, Consumers in the Financial Services Sector, Vol. 2, Chapter 3, Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 214.

[64] Wallis Inquiry Recommendation 9, quoted in Kell, Ibid., p 214.

will be on whether consumers understand a product's key elements, not whether they like and would buy the product.[65]

Disclosure Issues

Canada has numerous, and sometimes comprehensive, legal disclosure requirements. Governments in Canada have intervened in the marketplace primarily to prescribe certain types of information which must be disclosed to consumers. For instance, federal legislation governing banks and trust companies contains provisions on disclosure of account charges and the cost of borrowing.[66] Provincial legislation governing insurance companies and insurance intermediaries contains many provisions governing certain elements which must be included in insurance documents, or governing what intermediaries must disclose in dealing with a consumer.[67] It is unusual for institutions and intermediaries (apart from the requirements of securities legislation) to be required to file, or to seek regulatory approval for, contracts or other documents. Some provincial regulators do have an express power to intervene in the case of contracts or other documents which are not in the public interest because they are unfair or misleading.[68] Regulators also are known to intervene in specific instances, relying on moral suasion. There are some examples of statutory or regulatory measures that govern what documents a consumer must receive (for instance, a copy of an insurance application) or when a consumer must be advised of a particular matter.[69]

Several submissions to the Task Force, however, identified inadequacies in existing disclosure to consumers, particularly with regards to the sale of life insurance and life insurance documents.

The London Life Policyholders' Association stated that consumers do not have access to, or explanation of, the content and working of the policy they are purchasing at the point of sale when the application for insurance is completed. When the policy is received, the insurer's representative generally does not follow up with a review or explanation for the customer. Who bears risk, and what level of risk, may not be made clear to the customer. Apart from standard

[65] Quoted in Kell, op. cit., p. 216.

[66] Bank Act, S.C. 1991, c. 46, ss. 440, 454. Trust and Loan Companies Act, 5. C. 1991, c. 45, ss. 426, 440.

[67] See Insurance Act, R.S.O. 1990, c. I.8, as amended, s. 124, s. 127, s. 149 and ss. 175, 176 for examples of mandatory disclosure in insurance contracts. See Financial Institutions Act, R.S.B.C. 1996, c. 141, s. 90 as amended, for an example of mandatory disclosure by an intermediary. See also An Act respecting the distribution of financial services and products, S.Q. 1998, c. 37, c. II. See also: Osler, Hoskin & Harcourt, and Law Department, Canadian Life and Health Insurance Association, Laws and Rules Governing Life and Health Insurance Distribution Across Canada, Vol. III – Market Conduct (May 1996), c. 2.

[68] See, for example, Financial Institutions Act, R.S.B.C. 1996, c. 141, ss. 92 and 93.

[69] See Insurance Act, R.S.O. 1990, c. I.8, as amended, s. 125 and s. 174(4).

and clear contracts and codes of ethics for agents and brokers, the Association recommended that policy holders be given explicit rights in the contract. They urged that these contract rights should include the right:

- to full disclosure at all times during the policy term;
- to review the policy prior to the application for purchase;
- to deal with an insurer's representative who is not in a conflict of interest;
- to see the policy holder's own underwriting file;
- to privacy in the insurer's data base;
- to ongoing service; and
- to obtain redress.[70]

These concerns were echoed by the Independent Life Insurance Brokers of Canada (ILIBC). ILIBC argues that current disclosure requirements at point of sale are inadequate.

ILIBC maintains that, although the Canadian Life and Health Insurance Association (CLHIA) has a guideline on illustrations, it is not suitable as a basis for disclosure because not all companies are members of CLHIA, computers may not be available to generate the illustration on-site with the consumer, and it is available only in English and French.[71] Point-of-sale disclosure requirements must be practical since the consumer has a need for the coverage to be bound immediately.

As ILIBC recommends that only licensed agents may sell insurance, the disclosure requirements would fall on licensed agents. ILIBC suggests that fair disclosure means disclosure in writing at the time of sale of the face amount, annual premium, premium duration and risks (e.g., guaranteed vs. non-guaranteed) of a policy, preferably on the front cover of the policy.[72] Consumers should also be entitled to a written description of what they have applied for, a written assurance that the policy delivered is the same as that described, and a policy that is clearly worded and complete.[73] As provincial law defines what constitutes a contract of insurance, consumers should receive all parts of the contract (including the completed application and medical form).[74]

The Canadian Federation of Independent Business (CFIB) also supports enhanced disclosure of the terms and conditions of financial services.[75]

[70] London Life Policyholders' Association, Submission to the Task Force.

[71] Independent Life Insurance Brokers of Canada, Submission to the Task Force, pp. 6, 7.

[72] Ibid., pp. 6, 8.

[73] Ibid., p. 11.

[74] Ibid., p. 11.

[75] Canadian Federation of Independent Business, Submission to the Task Force, p. iii and p. 15.

London Life Policyholders' Association is critical of policy wording that allows changes in contractual provisions without the knowledge of, or input from, the policy holder.[76] Kerton also notes that this practice occurs in other financial services contracts as well, and he points out that this practice is considered unconscionable under new directives of the European Union.[77]

Another significant area in which practice in Canada is inadequate is the disclosure of fees and commissions – who is being paid and what they are being paid. Our rules (even in insurance, where some exist) are often faint-hearted and certainly inconsistent from industry to industry and from jurisdiction to jurisdiction. Statutory rules on disclosure of account charges and cost of borrowing applicable to banks and trust companies are a step in the right direction, although it is noteworthy that they were negotiated only after widespread and sustained public outcry. Information on fees and commissions is essential for the individual consumer and a necessary element of transparency.

Conclusion

Evidence indicates that the level of transparency of consumer contracts in Canada falls well below what consumers have a right to expect and industry is capable of delivering. Making progress is fundamentally a question of will – on the part of sellers, on the part of industry trade associations, on the part of regulators and governments, and on the part of consumers. The inescapable necessity to improve transparency and disclosure is a matter of public interest, although the burden of making progress must fall primarily on private shoulders.[78]

The Task Force notes the list of principles of transparency which Kerton has drawn from considering the literature on transparency and initiatives in other jurisdictions to improve transparency.[79] The Task Force considers several of these principles to constitute best practices which should be in use in the Canadian financial sector.

The first principle is presentation clarity. The logic must support comprehension. Short, direct sentences achieve much. The presentation must use the language, phrasing, illustrations, colour, images and media outlet appropriate for the resources of the target audience. Jargon, legal terms, charts and equations are to be used for audiences familiar with those methods and avoided for all others.

[76] London Life Policyholders' Association, op. cit., p. 2.

[77] Kerton, *The Consumer in the Future of Canada's Financial Services Sector*, p. 231.

[78] A 1997 Group of Ten report observes that transparency is often superior to a detailed set of regulations. Kerton, *Principles of Transparency and Redress as Components of Consumer Protection Policy*, p. 19.

[79] Ibid., pp. 22, 23.

The second principle is organizational clarity. The logic must be appropriate for the consumer. The format must highlight information that is important to the customer, whether by making skilful use of white space, pictures, borders and size of print, or through other means. An incentive problem ordinarily exists because the seller is not well motivated to draw attention to negative features, nor (in many cases) to facilitate price or quality comparisons. For this reason, many jurisdictions outside of Canada have specific rules requiring sellers to highlight information important to the consumer.

The third principle of transparency is brevity. Documents would be more approachable if the authors were more concise. Obviously, there is a trade-off between completeness and brevity. Perhaps the legal need for completeness has been too dominant as a motive. Whatever the reason, the remarkably long agreements in Canada's financial services sector impose serious burdens on conscientious consumers. Technology may bring relief to some: electronic transactions, carefully presented, may be able to present salient points clearly, with pointers to more detailed explanations. Perhaps too, some buyers will be able to choose explanations in different styles. In nearly every case, the brevity principle is key because transparency is greatly facilitated by conciseness. From the consumer's point of view, adequate transparency has been achieved when a communication has lowered the cost of search to an acceptable level.

The fourth principle is timing. All essential information must be provided before the purchase is made. The facts and details must be available when there is a felt need of the consumer. This does not oblige a consumer to undertake a preliminary search to find out where to look. The financial services sector may contain the most offensive examples of agreements arriving after the consumer has had to make the shopping choice. Further, Canada may be unique among developed countries in the extent to which contracts in the sector can be changed – without the permission of the consumer – after the purchase has been made. To facilitate transparency, the timing principle requires information to be available as it is needed.

The Task Force suggests that a number of initiatives could be implemented to improve the current situation.

First, the Task Force believes that the greatest progress will come in the shortest period of time from multipartite development of model forms for the types of contracts commonly used by consumers. There is ample evidence that having all key players at the drafting and negotiating table, sharing a common goal and working on a defined set of documents, produces results. In Canada, the Agreement for the Harmonization of Cost of Credit Disclosure Laws is an example of a multipartite effort which brought together consumers, industry and government to recommend a set of common principles (although not model forms).[80] This approach has been used in other countries to develop model forms. While some see it as slow and unwieldy, it is productive and it builds the consensus necessary to ensure implementation of the results. A multipartite forum requires leadership, which in jurisdictions that do not have established multipartite bodies usually comes from government.

Second, sellers must increase their commitment in terms of objectives, resources and implementation to ensure that consumer contracts meet adequate disclosure and transparency standards. As Colbert notes:

> Honesty, open-handedness, a sense of fair play and concerns for the effects of outcomes on others – qualities at the heart of many objectives of the [U.S.] laws … – cannot be legislated. Nonetheless, they lie at the root of transparent documentation.[81]

Good business practice in Canada should include the use of readable and comprehensible information and contracts, in whatever media they are released for use by consumers.

While not every document can be tackled at once, strategic choices can be made about where to start and milestones for completion of key documents can be developed. Further, the use of user testing for readability and comprehensibility should be extended and made an integral part of the development of documents. To encourage this, it is possible that the appropriate regulatory authority could audit for best practices and use moral suasion powers or existing regulatory powers with respect to contracts, disclosure or market practices to encourage and measure progress.

Third, governments should follow the same standard and ensure that any prescribed language is readable and comprehensible by consumers. Further, governments can advance the profile and penetration of Plain Language by incorporating it as a standard in any type of statutory disclosure as statutes are amended or new initiatives undertaken by statute.

It is unlikely that there will be widespread and meaningful disclosure of fees and commissions without government leadership and clear resolve. The Task Force supports this significant change and urges governments which have not done so to proceed quickly to require such disclosure. Further, the Task Force urges that jurisdictions introduce a statutory prohibition on the unilateral amendment of consumer contracts.

80 Canada, Consumer Measures Committee, Proposals for Harmonization of Cost of Credit Disclosure Laws in Canada, 1996.

81 Colbert, op. cit., p. 144.

The Task Force shares consumer unease about the nature and timing of disclosure as to who bears risk, and the nature of that risk, and how easy or hard it is to compare risk features of competing products (as well as other features). Canadian practice is not consistently adequate, and there are examples of disclosure failures (e.g., the vanishing premiums contracts noted by both the London Life Policyholders' Association and ILIBC). Industry and regulatory best practices, along with consumer vigilance, are essential if disclosure is to be improved.

Chapter 4

Privacy

Introduction

The focus of this chapter is privacy protection for financial services customers and, in particular, their control over their personal information. A study of this issue for the Task Force notes:

> In his book *Privacy and Freedom*, Alan F. Westin defined privacy as 'the claim of individuals, groups, or institutions to determine for themselves when, how, and to what extent information about them is communicated to others.' Westin's definition has been cited frequently in both academic literature and court decisions. It establishes a flexible conception of privacy which depends (at least to some degree) on the preferences of the individual. While Westin's definition provides a good starting point, it does not place enough emphasis on the treatment of personal information after its initial communication. Privacy includes also the interest of an individual to be notified of the compilation and exploitation of personal information in ways that alter the individual's relationship with others. At its core, privacy is about the ability of individuals to negotiate their relationships with others and to establish limits defining the legitimate use of information.[82]

In our society, privacy approaches the status of a basic human right in terms of the importance citizens ascribe to it generally. Concern for the protection of personal information grows as it becomes clearer that such information can be used in ways unknown and often unknowable by an individual. In practice, individuals differ in their attitude toward privacy. Some people see the accumulation, processing and dissemination of their personal information as a threat to their privacy. They fear a loss of their personal power to those who hold the information. Control of this information means to them the ability to limit the accumulation of information and its use by others. Others may see the provision of personal information and its dissemination as an opportunity. They welcome the ability of suppliers to use their personal information in order to better target their needs. For these people, control of information means allowing the wide use of information. Many people fit neither of these groups. Some may not wish to know the ways in which information is accumulated

[82] Richard C. Owens et al., *Privacy and Financial Services in Canada,* Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), p. 18.

and used. Others would be concerned if they knew. The public policy approach to privacy protection must have regard for this diversity of views.

How personal information is used is a matter of constant change whether one looks across a society or an economy, at a sector or an industry, or within a company or a file. Since the 1960s, our understanding of the role of information has changed dramatically:

> Public concern about privacy and the use of personal information spread in the 1960s, when governments and large businesses began to computerize their records. The computerization of personal records meant that personal information could be more easily sorted, combined, transferred and used for new purposes. Ultimately, computerization and the rise of the 'information society' led to the growth of new industries that collect, analyze and exploit personal information. Businesses, including financial institutions, developed new ways to market goods and services to their customers based on the personal information collected through routine transactions. The current capacity to 'warehouse' vast quantities of inexpressibly trivial personal information and then 'mine' that data for useful nuggets is important to businesses because it may provide them with a competitive advantage in the market.[83]

Most jurisdictions in Canada have implemented statutory regimes to protect the information interests of citizens in the public sector. The focus internationally and in Canada has shifted to the private sector. Financial services, information and telecommunications are among the most information-intensive sectors in the economy. Further, financial and health information are among the types of personal information considered the most sensitive. Internationally, statutory regimes to protect the information of citizens as they relate to the private sector are becoming the norm.[84] Quebec is the first jurisdiction to take this step in Canada.

Governments in Canada – provincial, territorial and federal – are engaged in serious discussions on harmonized legislation for the private sector. The Task Force is highly supportive of this initiative and takes it to be indicative of a public policy resolve to create a statutory regime. This chapter will concentrate on consumer interests and needs, and on choices for the design of a regime applying to the financial services sector, regulated and unregulated.

83 Owens, op. cit., pp. 20, 21.

84 The European Union, the United Kingdom and New Zealand have provisions governing the private sector as a whole. The United States takes a sectoral approach. Australia is taking a self-regulatory approach. Ibid., Part IV.

Current Privacy Protection

Legal Doctrine

The study prepared by Richard Owens includes an excellent summary of how common law and equity treat personal privacy, and of the implied contractual duty of privacy.[85] The implied contractual duty of privacy, the outcome of an English appeal case known as *Tournier*,[86] has been applied in Canada. Although the duty not to disclose personal information about a customer to third parties is clearest in the case of banks and their customers, it has had a direct effect on the form of the consent to use information, which customers sign virtually every time they contract for a financial service or product.

This is because one of the exceptions to the *Tournier* duty is that the consumer can consent to any disclosure by the bank to third parties. As a result, most consent forms executed by consumers include a broad clause which authorizes disclosure to a third party, including but not necessarily limited to credit reporting. Forms in use with consumers may reflect the desire of institutions to deal with the implications of *Tournier* more than they reflect genuine attempts to comply with the voluntary privacy codes.

It is important for consumers to have access to these judicially developed principles through the civil courts. As is the case with most consumer protection matters, however, it may be difficult for a customer to prove significant damages, and the resources required to bring a civil suit (particularly where there is little prospect of paying for it from damages recovered) limit the umbrella of protection available to consumers from this source.

Impact of the OECD Guidelines, the CSA Model Code and Voluntary Codes

In 1980, the Organization for Economic Cooperation and Development (OECD) adopted a set of personal information principles. They were intended to form the basis for legislation in member states, and indeed have proved influential in legislation all over the world. The guidelines placed a particular

[85] Owens, op. cit., Part II, pp. 43-51.

[86] [1924] 1 K.B. 461 (C.A.). "The English Court of Appeal held that there was no contractual requirement of absolute confidentiality between a bank and its customers. However, it found that there was an implied term of the banker-customer contract which required that consumer information be kept confidential, subject to four qualifications...

- where the disclosure was under compulsion by law;
- where there was a duty to the public to disclose;
- where the interest of the bank required disclosure; and
- where the disclosure was made with the express or implied consent of the customer."

Ibid., pp. 51, 52.

emphasis on the free commercial flow of personal information, as opposed to individual privacy rights.[87]

Canada, committing to the OECD guidelines in 1984, opted not to implement legislation for the private sector and instead encouraged the development of voluntary private-sector codes. By that time, the Canadian Life and Health Insurance Association (CLHIA) had a voluntary code in place (from 1980), which it revised in 1993. Other key industry organizations in the financial services sector responded with voluntary model codes for members: the Canadian Bankers Association (CBA) in 1990, the Insurance Bureau of Canada (IBC) in 1992, and the Trust Companies Association of Canada (TCAC) in 1993.

In 1996, the Canadian Standards Association (CSA), a non-profit organization, adopted its Model Code for the Protection of Personal Information (CSA Model Code). The CSA Model Code is generic in that it was developed for use by any entity, rather than a particular sector or industry. The Code, based on the OECD guidelines, was drafted by a committee of representatives of business, government and consumer groups. This process was itself a model of best practice which could be used much more extensively in Canada in the consumer protection area. The 10 principles of the CSA Model Code (which also includes definitions and an elaboration of each principle) may be summarized as follows:

1) *Accountability:* An organization is responsible for personal information under its control and shall designate an individual or individuals who are accountable for the organization's compliance with the following principles.
2) *Identifying Purposes:* The purposes for which personal information is collected shall be identified by the organization at or before the time the information is collected.
3) *Consent:* The knowledge and consent of the individual are required for the collection, use or disclosure of personal information, except where inappropriate.
4) *Limiting Collection:* The collection of personal information shall be limited to that which is necessary for the purposes identified by the organization. Information shall be collected by fair and lawful means.
5) *Limiting Use, Disclosure and Retention:* Personal information shall not be used or disclosed for purposes other than those for which it was collected, except with the consent of the individual or as required by law. Personal information shall be retained only as long as necessary for the fulfilment of those purposes.

[87] Owens, op. cit., p. 95.

6) *Accuracy:* Personal information shall be as accurate, complete and up-to-date as necessary for the purposes for which it is used.
7) *Safeguards:* Personal information shall be protected by security safeguards appropriate to the sensitivity of the information.
8) *Openness:* An organization shall make readily available to individuals specific information about its policies and practices relating to the management of information.
9) *Individual Access:* Upon request, an individual shall be informed of the existence, use and disclosure of his or her personal information, and shall be given access to that information. An individual shall be able to challenge the accuracy and completeness of the information and have it amended as appropriate.
10) *Challenging Compliance:* An individual shall be able to address a challenge concerning compliance with the above principles to the designated individual or individuals accountable for the organization's compliance.[88]

The Canadian Bankers Association amended its code to conform to the CSA Model Code in 1996, and the Insurance Bureau of Canada did so in 1997. The Credit Union Central of Canada (CUCC) has developed a model code that is slated to come into force in 1998.

How the codes have filtered down to the corporate level is unclear, as they are voluntary and the implementation time frame is open-ended. It appears they have had the greatest impact on large banks and property-casualty insurers. Indeed, most property-casualty insurers have agreed to use the IBC code without amendment. Redress mechanisms vary. In all cases the company is expected to be the starting point. In the case of the banks, customers may take a complaint to the internal bank ombudsman and, if not satisfied, to the Canadian Banking Ombudsman (CBO). In other cases, such as property-casualty insurers, there may be access to mediation.

Quebec Privacy Legislation

Quebec's Act respecting the Protection of Personal Information in the Private Sector, which came into force on January 1, 1994, is the first legislation in Canada imposing privacy principles on the private sector as a whole. Owens notes, "On a literal reading, the Act applies to banks as well as other financial institutions".[89]

The Quebec act contains a list of statutory duties which are more prescriptive than the voluntary codes. These include setting a standard for consent that is

[88] Owens, op. cit., pp. 28, 29.

[89] Ibid., p. 65.

higher than the voluntary codes; the requirement that a file be established as a condition of collecting information and that only information necessary for the file may be collected; and prescribing a process for the transfer of lists containing individual names, addresses or telephone numbers – nominative lists – to third parties. Several of these will be discussed below. Enforcement of the act is the responsibility of the Commission d'accès à l'information du Québec. In 1995-96, the Commission received 151 complaints relating to the private sector as a whole, of which 20 complaints (13 percent) related to deposit-taking financial institutions and 21 complaints (14 percent) related to insurers. Owens indicates that they dealt with cases in two main categories: those involving the collection or disclosure of information without consent, and those involving the wording of forms obtaining individual consent.[90]

Federal Initiatives

There are a number of provisions in federal financial institutions legislation relating to privacy. Statutory provisions require that financial institutions take reasonable precautions to ensure the protection and accuracy of their records.[91] The directors of a financial institution are required to establish procedures restricting the use of confidential information.[92] Other regulations made pursuant to the Acts place restrictions on the ability of certain institutions to share information with others.[93] Financial institutions are required to maintain certain records in Canada, although the processing of information may occur offshore if the Office of the Superintendent of Financial Institutions grants an exemption order.[94]

In its 1996 White Paper,[95] the Department of Finance announced its intention to create a statutory framework for regulation of privacy issues in the financial services sector. This was done in 1997 when the Bank Act, Insurance Companies Act, Trust and Loan Companies Act, and the Cooperative Credit Associations Act were amended.

[90] Owens, op. cit., pp. 36, 37.

[91] Bank Act, S.C. 1991, c. 46, s. 244; Trust and Loan Companies Act, S.C. 1991, c. 45, s. 249; Insurance Companies Act, S.C. 1991, c. 47, s. 267.

[92] Bank Act, S.C. 1991, c. 46, s. 157(2)(c); Trust and Loans Companies Act, S.C. 1991, c. 45, s. 161(2); Insurance Companies Act, S.C. 1991, c. 47, s. 165(2)(c).

[93] Bank Act, S.C. 1991, c. 46, section 416 and Insurance Business (Banks) Regulations, SOR/92-330; Insurance Companies Act, SC 1991, section 489 and 607, and Credit Information (Insurance Companies) Regulations, SOR/97-11; Trust and Loan Companies Act, SC, 1991, c. 45, section 416, and Insurance Business (Trust and Loan Companies) Regulations, SOR/92-331.

[94] Bank Act, S.C. 1991, c. 46, s. 245; Trust and Loan Companies Act, S.C. 1991, c. 45, s. 250; Insurance Companies Act, S.C. 1991, c. 47, s. 268.

[95] Canada, Department of Finance, 1997 Review of Financial Sector Legislation: Proposals for Changes, June 1996.

Three of those Acts, governing banks, insurers and trust companies, allow the Governor-in-Council to make regulations concerning the use of customer information (although no regulations have been issued).[96]

Further, the federal Ministers of Industry and Justice, on separate occasions in 1996 and 1997, committed to introducing legislation governing privacy in the private sector by the year 2000. Following up on these commitments, the Task Force on Electronic Commerce, a joint effort of the two departments, released a discussion paper entitled "The Protection of Personal Information" in January 1998. It stated:

> The Government of Canada is committed to setting clear and predictable rules governing the protection of personal information.… The Ministers of Industry and Justice have been jointly charged with developing the legislation, in consultation with the provinces and territories and with other stakeholders. Legislation that strikes the right balance between the business need to gather, store and use personal information and the consumer need to be informed about how that information will be used and assured that the information will be protected is key to building the consumer trust and market certainty needed to make Canada a world leader in electronic commerce.[97]

Consumer Awareness and Industry Response

Concern on the part of individuals about privacy is high. According to findings of the public opinion research conducted by Ekos Research Associates at the request of the Task Force, people believe that:

- average Canadians suffer serious negative consequences because of invasions of privacy by a range of entities, including but not limited to banks and insurers; and
- stricter rules are called for even if it means greater inconvenience for consumers.[98]

In scanning the data on complaints, Owens notes that there is no evidence of "widespread systemic failure."[99] The relatively small number of complaints under the Quebec Act, and to the bank ombudsmen and the Canadian Banking Ombudsman, and the consumer assistance centres of the Canadian Life and Health Insurance Association and the Insurance Bureau of Canada provide a

[96] Bank Act, S.C. 1991, c. 46, as amended, s. 459; Insurance Companies Act, S.C. 1991, c. 47, as amended, s. 489 and s. 607; Trust and Loans Companies Act, S.C. 1991, c. 45, s. 444.

[97] Industry Canada and Justice Canada, Task Force on Electronic Commerce, "The Protection of Personal Information: Building Canada's Information Economy and Society" (January 1998), pp. 2, 3.

[98] Ekos Research Associates Inc., *Public Opinion Research Relating to the Financial Services Sector,* Research Paper Prepared for the Task Force on the Future of the Canadian Financial Services Sector (Ottawa, September 1998), pp. 69, 70. See also Public Interest Advocacy Centre and the Consumers' Association of Canada, "Banking on Consumer Power: The Issues for a Canadian Consumer Coalition for the Banking Industry" (February 1998), pp. 59, 60.

[99] Owens, op. cit., p. 40.

brief period of experience. They do not constitute the basis for reliable conclusions about the degree to which customers are satisfied with the existing regime or with their treatment.

The profile that privacy protection measures receive in financial institutions varies considerably, as does the actual accessibility of the provisions governing an institution. Owens, as part of his research study, tried to obtain the privacy codes of various financial institutions.[100] Banks generally had materials available, either in print or on Web sites, although there were exceptions. Canada Trust has its own privacy policy based on the CSA Model Code, and has its own privacy brochure. Some other trust companies use the code and brochure of their parent bank. Some life insurers had information available, but difficulties were also encountered:

> ... an articling student assigned the task of obtaining privacy brochures or codes from several other insurers was unable to do so. A representative of the Aetna Life Insurance Company informed the student that the company has guidelines based on the CLHIA guidelines, but that they are not available to the public. Other insurance companies did not return calls, indicated that their companies apparently did not have privacy codes or failed to provide the student with material.[101]

The IBC Code for property-casualty insurers was intended to be adopted without amendment, and the companies which have adopted it (75 percent of the marketplace in terms of premiums) use it without publishing their own brochures or policies.[102]

Consumer knowledge about the privacy provisions governing a financial institution or entity with which a consumer transacts business is essential. In fact, how financial institutions conduct themselves with customers is just as critical to the protection of personal privacy as the standards of privacy protection themselves (assuming the standards meet some test of adequacy). Further, more and more relationships are going to be established by electronic or technological means, where there is no or very limited face-to-face contact with a representative of an institution or intermediary.

The significance of how a consumer is (1) informed of his or her privacy protection and (2) walked through his or her choices with respect to use and consent may be illustrated by reference to one of the voluntary codes. Given that most people in Canada have a bank account, the Canadian Bankers Association Privacy Model Code (based on the CSA Model Code) is used.

[100] Owens, op. cit., pp. 68-77.

[101] Ibid., p. 76.

[102] Ibid., p. 76.

Under Principle 2 of the Code, banks generally are required to identify the purposes of collecting personal information before or when the customer provides it. A list of standard purposes is established:

- to understand the customer's needs;
- to determine the suitability of the products or services for the customer or the eligibility of the customer for products and services;
- to set up and manage products and services that meet the customer's needs;
- to offer products and services to meet those needs;
- to provide ongoing service; and
- to meet legal and regulatory requirements.[103]

These may not be the only purposes, and indeed Principle 2.1 establishes that information can be used for other purposes.

According to the the Principles, when a customer applies for a product or service, the bank is to make sure the customer is made aware of:

- why the bank needs the personal information it is requesting;
- how the personal information may be used with customer consent for other purposes; and
- the fact that the customer can refuse permission for the bank to use personal information for these other purposes.[104]

There is discretion as to how the purposes are identified. It may be in writing, orally, in person or over the telephone, or by any other means of communication that a bank needs. The purposes are to be distinguished from other information so that they are more obvious to the consumer. Banks should be able to explain the purposes, using words that can be easily understood.[105]

The main provisions of Principle 3 indicate that a customer's consent can be expressed orally, in writing or electronically, or can be implied through action or inaction. Expressed, rather than implied consent is the preferred form. Significantly, the Code indicates that customers must consent specifically to the bank's using:

> Personal information (except for health records) to market products and services to its customers, either directly through the bank or through its existing subsidiaries or affiliates. The bank will get the consent of the customer before using personal information for this purpose.[106]

[103] Canadian Bankers Association, Privacy Model Codes (March 1996), Principle 2.2, p. 9.

[104] Ibid., Principle 2.1, p. 9.

[105] Ibid., Principle 2.3, p. 9.

[106] Ibid., Principle 5.3, p. 15.

This suggests that consumers must opt in to direct or targeted marketing.[107] However, because customers' consent can be implied by use of a bank product or service, or their failure to respond to the bank's offer to have their personal information removed from a direct marketing list, the system appears to function more like an opt-out system.

Consent can be withdrawn on reasonable notice.[108]

It will be obvious that privacy protection is an interactive process. Protection of the type, and at the level, desired by each consumer will not be obtained unless both the seller and the buyer engage in a review of the options available. The visibility and accessibility of redress mechanisms also are a factor in privacy protection. There is no question that if customers seek meaningful privacy protection, they need to be able to make their requirements known and follow through with complaints.

It is likely that consumer concerns about privacy protection will grow as changes in the structure and function of the financial services sector become more apparent. Targeted marketing (rather than mass marketing), for instance, is in common use in many sectors, including financial services. A number of voluntary codes address targeted marketing within a financial institution and its related companies; they require consumers to opt in initially and give them a standing choice to opt out. Still, codes vary in their provisions. Further, many consumers are asked to, and do, sign consent forms which authorize open-ended sharing of information with third parties.

Personal information used to be collected and kept product-by-product (in "data silos"). Increasingly, comprehensive customer information is maintained in a principal location which can be accessed by different users within a corporation or group (in "data warehouses").[109] The use of "data mining" is gaining public notice. Data mining involves the use of automated techniques to discover relationships among large quantities of aggregated data, relationships which may have nothing to do with identifiable persons.[110] Even when the results of the data mining are not traceable to individuals, they may suggest ways of segmenting customers that function like targeted marketing. Consumer concerns about both targeted marketing and data mining may go well beyond privacy and what privacy protection can deliver, as the methods may reflect an increasing shift in economic power and societal values. Privacy protection may not meet every concern which consumers have. But the challenge of privacy protection is to ensure that

[107] Canadian Bankers Association, Privacy Model Code, op. cit., Principle 3.3, pp. 11, 12.

[108] Ibid., Principle 3.5, p. 13.

[109] Owens, op. cit., p. 86.

[110] Ibid., p. 89.

it is effective in the face of rapid and unpredictable developments in the use of personal information.

It is worth noting again, in this context, that new commercial entities are playing major roles in providing financial products and services to customers. Many of these are not regulated financial institutions or intermediaries, falling outside the scope of much of the legislation in the sector. Increasingly, much transactional information, identifiable by consumer, is outside financial institutions and within credit card and debit card entities and smart card or stored-value card companies. The degree of privacy in any of these systems varies with its design and the voluntary approach to user privacy taken by the entity. It is not intended to suggest that privacy protection for consumers is or is not adequate in these systems. The aim is simply to point out that consumer needs in the financial services sector cannot be met solely by looking at regulated entities. The boundaries of the sector go well beyond regulated entities and are constantly changing.

Use of Medical Information

Currently, deposit-taking institutions have access to whatever medical information customers have given as part of the purchase of authorized insurance products distributed by deposit-takers. A specific area of concern is the possible use of medical information in decisions about access to credit. The CBA Code provides, in Principle 5, that health records be collected only for specific purposes, and that banks and subsidiaries not disclose health records to each other.[111]

Some provincial statutes have provisions relating to this concern. Noteworthy are the provisions of Quebec's Bill 188, assented to in June 1998, as Quebec is a jurisdiction which allows deposit-taking institutions to sell insurance and which also has privacy legislation covering the private sector. By and large, the same employee cannot be engaged in both traditional "banking" functions, including the extension of credit, and in insurance sales.[112] Medical and non-medical information collected in making an application for insurance must be recorded on different forms.[113] The medical or lifestyle information must be forwarded only to the insurer concerned; no copy relating to the application or any claim can be kept by a deposit institution, and it may not be disclosed to

[111] Canadian Bankers Association, Privacy Model Code, op. cit., pp. 15, 16.

[112] An Act respecting the distribution of financial services and products, S.Q. 1998, c. 37 (assented to June 20, 1998, not yet proclaimed in force), s. 29.

[113] Ibid., s. 33.

any other person.[114] An insurer may not disclose any medical or lifestyle information to a deposit-taking institution, even with the consent of the client.[115]

Information Exchanges

The exchange of much personal information in the financial services sector occurs through credit bureaus in the case of credit information and, in the case of insurance information, through the Medical Information Bureau (MIB), a United States company. Credit bureaus are regulated by the provinces (some have adopted voluntary codes), although Owens notes that the statutory standards vary.[116]

In the case of the MIB, member insurers in Canada and the United States provide basic information about insured persons to MIB based on authorizations such as the following: "I authorize each licensed physician, medical practitioner, hospital, clinic or other medical or medically related facility, insurance company, or other organization, institution or person that has any information regarding my health, to release it to [...]." Owens notes that Canadian residents may apply to the MIB at its Toronto office to gain access to their reports and that individuals may also request corrections of inaccurate information, although there is no Canadian legislation that regulates the operation of the MIB or guarantees the access and correction rights of Canadian residents.[117]

The MIB is only one example of an entity which, by function, forms part of the financial services sector but which would not be covered by provisions in federal or possibly provincial legislation/regulations governing financial institutions as such entities do not fall within the relevant definitions. The MIB probably would be covered by legislated privacy provisions for the private sector. This would be a positive step in the view of the Task Force as the MIB would be subject to at least the CSA Code standard of protection.

Conclusion

The Task Force agrees with the public expectation that privacy of personal information is a fundamental right, and is of the view that basic minimum standards should be legislated, setting out responsibilities of collectors and users of personal information and the nature of their relationship with providers. The Task Force therefore encourages the federal government to proceed expeditiously with its announced intention to legislate privacy provisions that will apply to private-sector entities.

[114] S.Q. 1998, c. 37, op. cit., s. 35.

[115] Ibid., s. 37.

[116] Owens, op. cit., p. 63.

[117] Ibid., pp. 64, 65.

There are a number of ways in which such privacy legislation can be framed and the Task Force understands that the Government has undertaken extensive consultations with businesses, governments and consumer groups as preparation for proposals that it plans to introduce in the fall of 1998. Although the Task Force does not have a strong preference on the most appropriate form of legislation, it believes that consumers will be better served if the legislation is comprehensive; that is, it should apply as broadly as possible to private-sector activity.

With respect to the principles that should underlie privacy protection, the Task Force offers the following comments:

- Legislation should set out basic minimum standards, building upon the CSA Model Code, that should be required in all privacy codes; the legislation should allow the flexibility for higher and more precise standards of behaviour in some sectors of the economy.
- Designated sectors such as financial institutions would be required to develop legally binding codes of conduct based upon the CSA Model Code and incorporating the standards applicable to that sector.
- The legislation would vest, in an appropriate entity, authority to prescribe the nature of the consultative process to be followed in developing such codes of conduct, to certify such codes as being in compliance with the legislation, and to develop and impose such codes itself where the designated sector did not respond in a timely manner.
- Notwithstanding that the focus of the legislation is likely to be "personal information" or "individual information," the Task Force notes that the privacy needs of small businesses should not be neglected.

There should be appropriate enforcement provisions and sanctions including:

- a regulatory authority that has at least the power to certify compliance, as suggested above, and to audit compliance, and possibly the ability to require registration of data users;
- a redress mechanism for consumer complaints that is separate from the regulatory authority; and
- a right of civil remedy.[118]

[118] The Task Force points to certain provisions of the U.K. Data Protection Act cited in Owens, op. cit., p. 107: "The Act also establishes a civil action for individuals harmed by misuse of personal information. An individual is entitled to compensation for any damage or distress suffered as a result of inaccuracy, loss, unauthorized destruction or unauthorized disclosure of data held by a data user."

Consistent with these principles, the Task Force would propose that privacy legislation for the financial services sector should contain the following specific elements:

With respect to basic minimum standards for new business:

1) Consumers enter into financial relationships with different objectives. Sometimes the person wants a specific product and only that product. At other times, the person is seeking a full-service relationship which goes beyond a single product or occasion. While the institution or intermediary may be more interested in developing a full-service type of relationship, it is the consumer's interests which should be dominant for purposes of privacy protection.

   It is a fundamental principle of privacy protection that data users be required to identify the purposes for which the data is to be collected. The level of specificity of that disclosure of purposes should be appropriate for the consumer's circumstances. If a consumer is seeking to build a full financial relationship, then the type of description included in the CBA Model Code may be appropriate. It includes such broad references as "to understand the client's needs" and "to offer products and services to provide those needs."[119]

   If, however, the consumer is entering into a specific transaction and that is the nature of the relationship, the above-noted identification of purposes is inadequate. In the Task Force's view, data users should be required to identify the purposes for which data is to be collected with sufficient specificity so that the provider can appreciate how it will be used, given the nature of their relationship.

   Further, the financial institution or intermediary should identify with appropriate specificity the nature of the information which may be sought about the consumer from third parties.

2) Consent to the collection, use or disclosure of personal information should be express, not implied.

3) In the specific case of information to be used to market other products or services to the customer, the customer must agree in writing to such use. This standard should apply to all circumstances that trigger the need for consent after the coming into force of the legislation (i.e., all "new consents"). If the consumer does not give such consent in writing, then the consumer is deemed to have refused consent. Any customer should have the right to revoke or alter a consent at any subsequent time.

[119] Canadian Bankers Association, *Privacy Model Code*, op. cit. Principle 2.2, p. 9.

4) The customer should be entitled to access his or her information file and to have any incorrect information amended. This should include any information received about the customer from any other entity. If access to any information in the file is denied, the customer should be entitled to know the specific grounds for denial of access.

   After the coming into force of the privacy legislation, existing customers of institutions must be given the opportunity to proceed under the new regime when obtaining a new product or service, or altering or revoking an existing consent. This means that the customer must be made aware of the new regime, and that the purposes for which data has been, or will be, collected must be disclosed with the appropriate degree of specificity. Further, the customer must be given the opportunity to express consent for the collection, use or disclosure, and written consent for direct marketing must be given, or the customer will be deemed not to have consented.

With respect to designated coverage:

1) The federal government should legislate a privacy regime that would apply to all federally incorporated financial institutions. The federal government should consult with provincial governments in order to arrive at a proposed legislative package that could form the basis for harmonized legislation across the country that would govern all financial institutions and intermediaries.
2) Provincial governments should, where they have not yet done so, legislate a similar regime that is harmonized with the federal regime to the extent possible. This would cover provincially incorporated financial institutions, financial intermediaries, and unregulated financial institutions that deal with individuals and/or small businesses.

With respect to certification of privacy codes:

1) The Office of the Superintendent of Financial Institutions should have the responsibility under the federal legislation for certifying the codes of industry associations and individual institutions, for prescribing the consultative process that should be followed in developing such codes, and for ensuring that compliance is audited.

With respect to redress:

1) In Chapter 6 of this paper, the Task Force proposes a public ombudsman system for the financial services sector. It would be appropriate that privacy complaints come through this channel.
2) In addition, governments should consider allowing civil remedies, including punitive damages, for breach of the certified privacy codes.

The Task Force recognizes that it may take some time to develop a consistent and comprehensive approach to privacy legislation for the private sector. It urges the Government not to wait unduly for a comprehensive package in order to deal with financial services sector issues, but to press ahead with a regime that can be implemented for the financial services sector as expeditiously as possible – building on existing infrastructure, such as the current privacy provisions in the relevant authorizing legislation and the existence of OSFI, and the early creation of the new ombudsman office.

The Task Force urges that any jurisdiction regulating privacy pay particular attention to the collection and use of medical information as this is at least as sensitive as financial information. The Task Force endorses the rigorous approach taken in Quebec with respect to the collection and use of health information in the case of insurance sold through a deposit-taker. The Task Force urges the adoption of similar legislation in every jurisdiction with authority over such sales.

Further, special regard must be given in any privacy legislation governing the financial sector (whether it is of general application or applicable only to the sector) to the collection and use of health information more generally, including the role of customer consent, disclosure to third parties, access and correction. Principle 5 of the CBA Code is a starting point but it may not be sufficient to address all of the emerging issues.

Chapter 5

Coercive Tied Selling

Introduction

Public awareness of tied selling has grown as an expanded and more integrated financial services marketplace has become a reality. Tied selling may be the most prominent consumer protection issue of the 1990s as it puts into stark relief the issue of bargaining power between consumers and institutions or intermediaries.

"Tied selling" is a term developed in law to describe any type of selling arrangement in which one product (the "tying product") is offered to a customer, on condition that the customer purchase another ("the "tied product").[120] Tied selling is pervasive in the marketplace. It is confined neither to the financial sector nor to one particular type of institution within the sector. Each financial institution offers certain products within its corporate group and may also be networked with other suppliers. Many intermediaries, such as life insurance agents and stockbrokers, hold a number of licences entitling them to distribute different types of products. New entrants and new products are constantly coming into the marketplace.

Tied selling often brings benefits to consumers and is in their best interest. For instance, in the case of banking, products and services may be bundled in a

[120] For example, over the last century, common law developed a restraint-of-trade doctrine whereby certain horizontal and vertical restraints found in commercial (not consumer) contracts were challenged before the courts. Generally, a contract in restraint of trade is one in which one party agrees with another party to restrict his or her future ability to carry on trade with a third person not party to the original contract. Vertical restraints are "restrictions" which operate between a firm at one level of an industry, and another firm at a lower or higher level in manufacturing or distribution chain in the same industry. (Micheal Trebilcock, *The Common Law Restraint of Trade* (Carswell 1986), p. 307.) One type or vertical restraint is tied selling.

The courts will assume a vertical restraint of trade to be unenforceable unless the party defending it can show it to be reasonable with regard to the public interest (Trebilcock, ibid., p. 321) and reasonable as between the parties. Reasonableness between the parties will be easier to establish if the parties are "equally situated commercial parties,"(Trebilcock, op. cit., p. 321) but harder to establish if there is inequality of bargaining power.

There are very few judicially determined cases involving the vertical restraint of tied selling between commercial entities, and apparently none where a retail consumer has sought to challenge a contractual arrangement with a financial institution or otherwise.

It is worth noting that in its original usage at common law, "tied selling" is a neutral term describing a commercial practice which could be either unenforceable or enforceable, if it were found to be reasonable as between the parties and compared to the public interest.

monthly service plan or attached to a credit card. Loans may be available at a cheaper rate if another product or service is purchased. In the case of insurance, traditional life insurance and savings may be combined into a single product.

What is attracting public scrutiny and concern is tied selling which is perceived to be coercive and contrary to consumers' best interests. For instance, in the case of banking, a new or established individual or small business customer may be told that he or she must do more of his or her business with a particular branch in order to obtain one desired product or service (e.g., a home mortgage or a business loan). In the case of insurance, automobile insurance may not be available unless all coverages are purchased from one insurer.

It is difficult to define what constitutes acceptable tied selling and unacceptable tied selling. Presented with identical circumstances, individual customers may react in different ways. The following elements, however, are usually present in unacceptable tied sales in the financial services sector:

- the customer is seeking a product or service which is important in his or her personal or business circumstances;
- the seller has a yes/no decision to make about whether to offer the product or service;
- the customer has limited options to obtain that product or service in another format within the institution or group and probably will have to move his or her business to obtain it or, worse, may not be able to obtain it elsewhere; and
- the tied sale is economically disadvantageous to the customer, or will result in adverse consequences, but is perceived to be advantageous to the seller.

Many other factors can enter into the equation. Institutions or intermediaries often have extensive personal information on customers, either collected for the specific transaction involving the tied selling or for other purposes. This is particularly so where loans are involved. While in theory the customer can walk away from the tied sale offer, in practice customers may face barriers (availability, complexity and cost) to moving their business and may feel that their trust has been abused and their loyalty has not been rewarded. How the sale is conducted, including the extent of disclosure, may also be a factor.

There is a growing tendency to label any beneficial or acceptable type of tied selling as "cross-selling"; the terms "bundling," "incentive pricing" and "relationship selling" also are sometimes used.

Tied selling generally does not flow from institutional policies which condone coercion, and there is broad agreement that tied selling which is coercive, not beneficial, is an unacceptable business practice.

Consumer Context and Concerns

How financial institutions interact with, regard and treat their customers is not an academic issue for Canadians. Almost all Canadians use financial services directly, whether in person or through technological means.

Individual Canadians tend to use one institution primarily, and that institution is likely to be a Schedule I chartered bank (61 percent of Canadians), although in Quebec 51 percent use caisses populaires.[121] Still, one Canadian in three indicates that he/she uses more than one institution.[122] Canadians tend to do their personal banking and lending at one institution (at least two out of three have obtained their mortgages, loans and credit cards from their primary financial institution), although fewer Canadians rely on their primary financial institutions for Guaranteed Investment Certificates (GICs) or mutual funds (45 percent purchased all their GICs from their primary institutions and 26 percent purchased all their mutual funds from their primary institution).[123]

Regardless of how the relationship between consumer and institution or intermediary might be strictly characterized in law (e.g., debtor-creditor, fiduciary, agent, broker), consumers often place trust in those with whom they deal on a day-to-day basis and look to institutions and intermediaries for advice which serves them as consumers. In many cases, consumers also offer loyalty and expect loyalty, in all of its manifestations, in return. This is reinforced by institutions and intermediaries, which are positioning and advertising themselves to be in the business of relationships, of advice, of individualized financial management.

If expectations of trust and loyalty generally characterize the relations between financial institutions, intermediaries and their customers, an important consideration is the degree to which customers can ascertain whether they are being treated appropriately – that is, how transparent is the relationship. In the Task Force's view, it is undeniable that the level of overall transparency of the customer to the institution/intermediary is higher than that of the institution/intermediary to the customer. In other words, even the most determined customer will face limits on disclosure to him or her about everything relating to the institution/intermediary side of the transaction. Although the Task Force has specific proposals in Chapter 3 of this paper on key aspects of transparency, the customer is rarely in a position, in a particular transaction, to know as much about all the factors at play as is the institution or intermediary.

121 Ekos, op. cit., pp. 14, 15.

122 Ibid., p. 12.

123 Ibid., pp. 16, 17.

For instance, one of the principal by-products of the relationship between a customer and an institution or intermediary is information. The information flow is two-way: personal or business information of various types is supplied to the institution or intermediary, and product, risk and cost information is conveyed to the customer. This information exchange is critical to support the decision making of both parties in any transaction. Much of the information supplied by customers is factual and verifiable. Much of the information supplied by institutions and intermediaries may be factual, although it may be very difficult for an individual customer to verify it. Some key information on the institution or intermediary side may not be visible or verifiable – for example, how the seller is compensated for a sale, or the relationship between the product or service and seller profitability.

Given the trust placed by customers and limits on the transparency of the relationship, the Task Force believes that Canadians have a right to expect very high standards of behaviour, including sales behaviour, from financial institutions and intermediaries.

Although there may be a limited number of publicly known examples of tied selling where the existence of coercion is established, the perception or concern that consumers may be vulnerable to coercion is a reality. Ekos Research Associates asked the following question of a sub-sample of Canadians who had received loans or mortgages in the last three years:

> Have you personally ever felt that one of your loans or mortgage may not be approved unless you also purchased another product like insurance from your institution?

Of the respondents, 16 percent said yes, 4 percent were unsure and 80 percent said no. Responding to the follow-up question "What did you do?" (which was put to the respondents who said yes), 46 percent said they purchased the other product, 26 percent said they did not purchase the product at all, 8 percent took their business elsewhere and 7 percent complained to the institution's manager (the remaining 12 percent did "other" things).[124]

In the Task Force's view, concern about, and consideration of, tied selling is justified, given conditions in today's marketplace. Tied selling is likely to become more frequent as more institutions become conglomerates selling multiple products and as networking arrangements increase. While this does not necessarily imply an increase in coercive tied selling, the potential for coercive practices will grow.

[124] Ekos, op. cit., pp. 63, 64. See also PIAC and CAC, "Banking on Consumer Powers: The Issues for a Canadian Consumer Coalition for the Banking Industry", op. cit., pp. 64, 65.

Statutory Provisions in the Competition Act Governing Tied Selling

Nations have a range of interests in fostering competitive markets in order to provide both public and private benefits. One of the principal tools used by the federal government in Canada, which has constitutional jurisdiction over competition law, is the Competition Act.[125] The Competition Act has provisions governing tied selling in section 77.

Tied selling is defined in section 77 (1) to mean:

> (a) any practice whereby a supplier of a product, as a condition of supplying the product (the "tying" product) to a customer, requires that customer to:
>
> i) acquire any other product from the supplier or the supplier's nominee, or
>
> ii) refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacturer designated by the supplier or the nominee; and
>
> (b) any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (a)i) or ii) by offering to supply the tying product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs.

Given that "practice" is not defined in the Competition Act, the definition of tied selling is a broad one, although it must be noted that, as in the common-law restraint of trade, the focus is on commercial transactions, not on consumer transactions.

Engaging in tied selling is not, per se, a violation of the Competition Act, nor, as noted below, does it give a right to proceed with a private cause of action. The Competition Tribunal, on application from the Director of Investigation and Research, has the authority to order sellers not to engage in tied selling after a finding that:

- it is being engaged in by a major supplier or is widespread in a market;
- it is likely to impede entry or expansion of a firm, or sales of a product in the market, or have some other exclusionary effect; and
- it lessens competition substantially, or is likely to do so.[126]

[125] Competition Act., R.S.C. 1985, c. C-34.

[126] Ibid., s. 77(2).

The Tribunal cannot make an order when a practice:

- is engaged in by a person in the business of lending money for the purpose of better securing loans made by that person and is reasonably necessary for the purpose;
- occurs as a result of a reasonable technological relationship; or
- is necessary for a reasonable period in order to facilitate entry of a new supplier or product.[127]

The Competition Tribunal does not have jurisdiction to award general damages, although there is a statutory civil right of action for damage suffered because of non-compliance with an order.[128] Failure to comply with an order of the Competition Tribunal is an offence.[129]

There have been no cases of tied sales brought before the Competition Tribunal under section 77 of the Competition Act.

Statutory Provisions in the Bank Act Governing Tied Selling

The Bank Act has contained, for decades, a provision which prohibits banks from exercising "pressure on a borrower to place insurance for the security of the bank with any particular insurance company" (although it may require that the insurer must be approved by the bank).[130] Since 1997, the Bank Act (and only the Bank Act, as a similar amendment was not made to federal statutes governing trust and insurance companies) has included an unproclaimed section with respect to tied selling (s. 459.1). The long-standing provision will be repealed when section 459.1 is proclaimed as its content is included in section 459.1.

The federal government agreed with the House of Commons Standing Committee on Finance that section 459.1 would be proclaimed and come into force on September 30, 1998, after the Finance Committee held hearings on tied selling. Hearings were held in March 1998, and in June 1998 the Finance Committee recommended that the section be proclaimed.[131] For ease of reference, the provision is cited here in full:

[127] Competition Act, p. 77(4).

[128] Ibid., s. 36(1)(b).

[129] Ibid., s. 74.

[130] Bank Act, S.C. 1991, c. 46, s. 416(5). S. 381(5) of the Co-operative Credit Associations Act and s. 416(5) of the Trust and Loan Companies Act also prohibit pressure with respect to the placing of insurance as security for a loan.

[131] Canada, House of Commons Standing Committee on Finance, "Report on Tied Selling: Section 459.1 of the Bank Act", 7th Report, (June 1998).

459.1 (1) **Restriction on tied selling**. – A bank shall not impose undue pressure on, or coerce, a person to obtain a product or service from a particular person, including the bank and any of its affiliates, as a condition for obtaining a loan from the bank.

(2) **Favourable loan tied to other sale**. – For greater certainty, a bank may offer to make a loan to a person on more favourable terms or conditions that the bank would otherwise offer to a borrower, where the more favourable terms and conditions are offered on the condition that the person obtain another product or service from any particular person.

(3) **Favourable other sale tied to loan**. – For greater certainty, a bank or one of its affiliates may offer a product or service to a person on more favourable terms or conditions than the bank or affiliate would otherwise offer, where the more favourable terms and conditions are offered on the condition that the person obtain a loan from the bank.

(4) **Bank approval**. – A bank may require that a product or service obtained by a borrower from a particular person as security for a loan from the bank meet with the bank's approval. That approval shall not be unreasonably withheld.

(5) Regulations. – The Governor in Council may make regulations

(a) specifying types of conduct or transactions that shall be considered undue pressure or coercion for the purpose of subsection (1); and

(b) specifying types of conduct or transactions that shall be considered not to be undue pressure or coercion for the purpose of subsection (1).

To date, no draft regulations have been released. When section 459.1 is proclaimed, contravention of it will constitute an offence under section 561 of the Bank Act, exposing the bank to a fine and bank employees to a fine or imprisonment under section 566. By virtue of section 568 of the Bank Act, any contract made as a result of the application of undue pressure or coercion would not be invalidated.

Section 459.1 focusses on a significant bank power: that of granting or denying credit. It prohibits a bank from tying the *availability* of a loan to the purchase of another product or service of the bank or its affiliates. If security for a loan is required, the bank is given authority to approve the actual product or service proposed by the borrower (as opposed to requiring that the borrower provide security chosen by the bank). More favourable terms and conditions may attach to a product or service if a loan is obtained, and vice versa. Thus, a bank may offer a reduced interest rate on a loan to acquire a bank registered savings plan, or a bank may pay higher interest rates on deposits or reduce service fees if the customer borrows from the bank.

Section 459.1 conforms, but only in part, with the recommendations made by the House of Commons Standing Committee on Finance and the Senate Committee on Banking, Trade and Commerce, both of which held public hearings on the White Paper. The House of Commons Standing Committee on Finance rejected the argument that section 77 of the Competition Act was sufficient to address the circumstances of retail consumers:

> The Committee does not believe that any of its concerns about the tied selling of financial services can be dealt with by the Competition Act prohibitions since undue pressure on an individual consumer would not meet the test of substantially lessening competition in that market. Accordingly, arguments to the effect that the Competition Act can resolve this Committee's concerns about tied selling are specious.[132]

Both committees considered a proposal from the Independent Investment Dealers Association (IIDA). The IIDA argued that, consistent with the current subsection 416(5), a bank should be prohibited from exercising any pressure on a borrower. Both committees, however, recommended that a test which prohibited any pressure might inhibit beneficial or acceptable tied selling. Instead, the committees recommended banning "undue pressure." According to the Standing Committee of Finance, the Consumers' Association of Canada (CAC) concurred that what is important is that the pressure not be undue or coercive.

Both committees recommended that all federal financial institution statutes be amended in the same way, although both recognized that there might be constitutional difficulties.

Provincial Measures Relating to Coercion and Tied Selling

Consumer protection related to the formation and enforcement of contracts, including contracts for the purchase of most types of financial services and products, has been a primary focus at the provincial level, given Canada's division of constitutional authority. A review of existing or proposed regulatory provisions suggests that it has been considered necessary to reinforce or expand by statute any protection at common law or in civil law against the unequal exercise of bargaining power, and that this has been particularly important in circumstances where products and services are being actively marketed and sold. Such a review also provides illustrations of consumer-based approaches to conduct and (to a lesser extent) remedial actions.

[132] Canada, House of Commons Standing Committee on Finance, "1997 Review of Financial Sector Legislation: Proposals for Changes", 4th Report (October 1996), p. 5. See also Canada Senate Committee on Banking, Trade and Commerce," 1997 Financial Institution Reform: Lowering the Barriers to Foreign Banks" (October 1996), pp. 42, 43.

Most provincial statutes governing the sale of insurance have a provision prohibiting a seller from coercing a buyer to purchase insurance. For instance, section 177(c) of the Financial Institutions Act[133] of British Columbia provides that agents must not coerce a prospective buyer of life insurance through the influence of a business or professional relationship, or otherwise give a preference in respect of the placing of life insurance. Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland address coercion in similar form.[134] In Alberta, which has generic legislation governing financial consumers, a prohibition encompasses all suppliers and financial planners, as well as agents.[135] The prohibited activity is described variously as "coercion," "undue influence," "undue pressure" or "undue advantage," and some provisions cover both direct and indirect actions. Generally, breach of the provision constitutes an offence, but the consumer is not provided with a direct remedy such as rescission.

The codes of conduct governing insurance agents and brokers also generally prohibit the use of coercion.

Increasingly, tied selling is being specifically addressed in provincial regulation (see the Appendix to this paper). The provisions do not, necessarily, ban all tied selling. One of the most significant features of the provisions is that they can recognize and validate the relevance of an individual consumer's perspective; that is, it is the consumer who makes the determination as to whether the tied selling is coercive.

Under the British Columbia provision, a person cannot be "required" to transact additional or other business with a financial institution as a condition of any product or service transaction with a limited exception provided by regulation, i.e., a customer may be requested to have an account with the institution if the provision of a product or service is facilitated by an account. British Columbia regulators interpret this provision to mean that all tied selling, even when it might be beneficial to the consumer, is prohibited. It appears that a similar approach is proposed in Saskatchewan. The approach is different in Quebec statute law. With respect to insurance, a person cannot be obliged to make another contract (the tied contract) where one (the tying contract) is being

133 Financial Institutions Act, R.S.B.C. 1996, c. 141, s. 177(c).

134 Alberta: Insurance Act, R.S.A. 1980, c. I-5, s. 512 and A. leg 32/89, ss. 3(2)(g), 3(3)(c), 3(6), 4(2)(a), 4(3), 4(6). Financial Consumers Act, S. S.A.C. F-9.5, s. 16. Saskatchewan: The Saskatchewan Insurance Act, ss., c. S-26, ss. 445(c). Manitoba: Insurance Act, S.M., c. I-40, s. 113 and ss. 378(12). Ontario: Insurance Act, R.S.O., 1990, c. I.8, s. 438 and 439 and O. Reg. 663, s. 4(1). New Brunswick: Insurance Act, S.N.B., c. I-12, ss. 369.1 to 369.5. Nova Scotia: Insurance Act, I.S.N.S., c. 231, ss. 36(8)(e). Prince Edward Island: S.P.E.I., c. I-4, ss. 376(2)(c), Newfoundland: Insurance Adjusters, Agent and Brokers Act, R.S.Nfld., 1990, c. I-9, ss. 45(7)(b), all provisions to be read as amended.

135 Financial Consumers Act, S.A., c. F-9.5, s. 16.

made. The current provision allows a set of financial products to be offered at a reduced cost. Although the Bill 88 provision does not explicitly address price inducements, it presumably is considered not necessary to do so, as they can be offered but a purchaser cannot be obliged to purchase the package. If however the insurance contract is cancelled, the price inducement on the other contract may be lost.

British Columbia is the only province which requires disclosure to customers that coercive tied selling is prohibited: all agents are required to disclose this in writing to the customer before arranging a transaction.

The above-noted provincial provisions offer very limited consumer-driven remedies. Only in Quebec may a person upon whom a contract of insurance was imposed cancel that contract by sending written notice within 10 days of the date the contract was signed.

Rules governing the tied selling of mutual funds are in transition. Those dating from 1988 and contained in the "Principles of Regulation Re: Distribution of Mutual Funds by Financial Intermediaries" did not contain an explicit prohibition on any form of tied selling. New rules and policies proposed by the Canadian Securities Administrators (CSA) that have started to come into effect from province to province are more far-reaching.

Under proposed National Instrument 33-104 and Companion Policy 33-104CP,[136] Selling Arrangements, a selling arrangement notice must be delivered by a securities registrant to the securities regulator before the former enters into a selling arrangement under which a dealer agrees to attempt to induce a client, or requires a client (as a condition of dealing with or purchasing a product or service from the dealer) to deal with or purchase a product or service from a Canadian financial institution. No notice is required, except in Quebec, if the selling arrangement relates to an inducement and the inducement does not result in the client's paying more for the product or service provided by the registrant. In British Columbia, a notice is required if the proposed selling arrangement is between a registrant and a Canadian institution to which the registrant is not a related party. The appropriate regulator determines whether the arrangement accords an adequate level of investor protection or otherwise raises public interest concerns. These provisions govern the tying of the sale of financial institution (FI) products to the sale of mutual funds, not the tying of mutual funds to the sale of FI products. As before, they do not appear to address ad hoc tying that is not an explicit part of a selling arrangement.

[136] Notice of Proposed National Investment 33-104 and Companion Policy 33-104, CP – Selling Arrangements, (1997) 20 OSCB 6921 (November 28, 1997), s. 6.1.8 and following.

The ad hoc tying of mutual funds to the sale of FI products is covered by a companion provision in National Instrument 81-105 and Companion Policy 81-105CP, Mutual Fund Sales Practices, as follows:

> 7.4 Tied Selling – No person or company shall require another person or company
>
> (a) to invest in securities of a particular mutual fund or mutual fund family, either as a condition or on terms that appear to a reasonable person to be a condition, of supplying or continuing to supply products or services; or
>
> (b) to purchase or use any products or services, either as a condition or on terms that appear to a reasonable person to be a condition, of selling securities of a particular mutual fund or mutual fund family.[137]

The CSA is of the view that the reference to "products and services" includes the opening of an account.

Industry Statements on Tied Selling

In 1997, the then Chair of the House of Commons Standing Committee on Finance urged all financial institutions to adopt their own codes of conduct concerning coercive tied selling, as well as to educate their employees and customers. The Canadian Bankers Association has responded with its Statement on Tied Selling, released in early 1998 and subsequently amended, which is applicable to its members. The CBA believes that self-regulation has worked in the past, and that self-regulation can continue to effectively protect the interests of customers.

The Statement applies to all retail and small business customers, but not to corporate customers (all customers would receive the protection of section 459.1). It follows the language of subsection 459.1(1) in its principal pledge. It specifically addresses the management of credit risk and states in part:

> Any requirements imposed for the purpose of managing credit risk will be consistent with the level of risk being undertaken, and will be for the sole purpose of managing that credit risk.

The Statement confirms that the senior management of each bank is committed to, and is responsible for, upholding the Statement, and it lists the means the banks will use, including staff training, customer information, complaints and redress mechanisms, and audit procedures.

The Statement is to be available in brochure form in bank branches and, in some cases, in electronic form on bank Web sites.

[137] Notice of Commission Approval of National Investment and Adoption of Companion Policy under Securities Act, 1998, (1998) 21 OSCB 724 (February 6, 1998), s. 1.1.3 and Chapter 5.

The Canadian Life and Health Insurance Association adopted Guidelines on Screening Life Agents for Suitability and on Reporting Unsuitability effective January 1, 1998. Insurers are required to complete and file, with the appropriate provincial insurance regulator, a form reporting on the contravention by agents of provincial insurance acts and regulations, or on other unsuitable actions. An agent must be reported if coercion is used to make a sale or if a pattern of coercion exists, or if the agent conducts tied selling activities. It is then up to the regulator to investigate and to take regulatory action.[138]

Comparison with the United States

In the United States, tied selling generally is regulated under the anti-trust provisions of the Sherman Antitrust Act.[139] In order for tied selling to be prohibited under these provisions, it must be shown that (1) the seller has market power in the market for the tying product; (2) the tying arrangement has had an anti-competitive effect in the market for the tied product; or (3) the tying arrangement has had a substantial effect on interstate commerce.

Tied selling by banks, however, is also regulated under section 106 of the Bank Holding Company Act Amendments of 1970.[140] Banks are prohibited from restricting the availability or varying the consideration of the tying product on the condition that a customer purchase another product or service – the tied product – offered by the bank or any of its bank affiliates. There is a significant exception to the scope of this provision, known as the "statutory traditional bank product exception." A bank is permitted to tie any product or service to a loan, discount, deposit or trust service offered by that bank. For example, it could require that a customer conduct all its deposit business at that bank as a condition of obtaining a loan. In 1971, the Federal Reserve Board, by regulation, extended the coverage of these rules to bank holding companies and their non-bank subsidiaries. It reversed that extension in February 1997, citing the competitive vitality of the markets in which non-banking companies generally operate and noting that they would thereby obtain the same freedom to package products that their competitors currently enjoy. At the same time, it extended the traditional bank product exception to include those same products when offered by a bank affiliate.

According to the Federal Reserve Board, section 106 "restricts tying arrangements by banks on the grounds that the unique role of banks in the economy, in particular, their power to extend credit, would allow them to gain a competitive

[138] Canadian Life and Health Insurance Association, "Coercive Tied Selling", Submission to the House of Commons Standing Committee on Finance (March 1998), p. 6.

[139] 15 U.S.C. s. 1.

[140] 12 U.S.C. s. 1972.

advantage in other markets."[141] A May 1997 report of the General Office of Administration (GAO) states:

> Congressional records indicate that policymakers made plaintiffs' burden of proof less stringent [than antitrust law] because they believed that proving an antitrust violation involving banks, bank holding companies, and subsidiaries could pose difficulties for plaintiffs. Their reasoning was that few plaintiffs could be presumed able to readily ascertain a bank's economic power in a particular product or service market and its ability to impose a tying arrangement.[142]

Section 106 and the unproclaimed Bank Act (Canada) section 459.1 are similar in one respect: the prohibitions fall on banks, not on bank affiliates (i.e., they are one-way). In other respects, they are different.

First, section 106 is a prohibition on restricting availability or varying consideration; that is, it operates as a ban. Section 459.1, does not operate as a ban on all tied selling but prohibits coercion in the transaction.

Second, section 106 is different in scope in that it prohibits tying of products or services of that bank or its affiliates, with the exception of traditional bank products offered intra-bank – itself a broad exception. Section 459.1, on the other hand, prohibits tying products or services as a condition of obtaining a loan from a bank, covering both intra-bank and inter-affiliate tying where the tying product is a bank loan. Also, the fact that bank products can be tied to the products of bank holding companies and non-bank subsidiaries is a narrowing of the scope of section 106 (apart from the situation where the tying product is a loan, they can be tied under section 459.1 as well).

Third, section 106 is stricter: in addition to prohibiting a bank from restricting the availability of one product or another, it also prohibits varying consideration. Section 459.1 allows price inducements.

Fourth, the enforcement mechanisms are different, reflecting in part fundamental differences in legal development and remedial preferences. Violations of section 106 may be redressed through: (1) an enforcement action for civil money penalties brought by the appropriate federal banking agency; (2) an action for injunctive relief brought by the Justice Department or any person who can show "danger of irreparable loss or damage"; or (3) a civil suit brought by "any person who is injured in his business or property by the prohibited arrangement,

[141] Federal Reserve System, 12 CFR, Part 225, p. 7.

[142] General Accounting Office, "Bank Oversight: Few Cases of Tying Have Been Detected", no. GAO/GGD-97-58, p. 4.

with the court to award treble damages and attorney's fees if the plaintiff prevails."[143] Breach of section 459.1 would constitute an offence subject to prosecution by the federal Crown; Canada does not have a private enforcement mechanism.

The May 1997 GAO Report cited earlier provides some interesting perspectives on tying provisions in the United States. The report did not draw conclusions on whether the policy rationale for section 106 was still valid. Although banks' share, measured by assets, of the financial intermediaries market had declined overall, off-balance sheet credit-related activities of banks had grown. The report found limited evidence of tying activities by banks on the basis of the results of regulatory audits, private litigation and interviews with a range of interested parties, but it indicated that there was no consensus on why that was the case or what it implied:

> ... explanations that possibly account for the lack of evidence include consumers' reported reluctance to make formal complaints and the difficulty of detecting tying practices. Some bank representatives maintain … that tying is not occurring to a significant extent because market forces allow few opportunities, and that provisions are thus unnecessary. Others, including some regulators and representatives of securities firms, agree that the lack of evidence indicates little tying is occurring but maintain that the absence of tying is a result of the deterrent effects of the tying provisions and the associated regulatory monitoring. It … may also reflect consumers' reluctance to make formal complaints, as in instances we encountered when borrowers were reportedly reluctant to talk with us for fear of jeopardizing their relationship with a bank. Finally, the possibility cannot be ruled out that the shortage of evidence of tying may indicate the difficulty consumers or regulators have identifying tying violations.[144]

Industry representatives had the same divergence of opinion as in Canada on the value of anti-tying provisions. Although the Federal Reserve chose not to take an official position on the need for tying provisions, the Office of the Comptroller of the Currency cited the provisions' importance in making banks aware of their responsibilities to customers as they provide an increasing array of products and services.

Comparison with the United Kingdom

The focus in the United Kingdom has been on tied sales of a particular type of product known as "packaged mortgages" – that is, mortgages and other products, usually insurance, in a combined package.[145] Existing statutory powers to

[143] Federal Reserve System, op. cit., p. 41.

[144] GAO, op. cit., p. 12.

[145] Information on the United Kingdom is drawn from correspondence between Jeremy Mitchell and research staff of the Task Force.

address problems have not yet been proclaimed. They were designed to increase transparency by ensuring that lenders give house buyers the information they need to choose between a free-standing mortgage and a mortgage offered with tied-in services, such as insurance.

In a June 1994 paper entitled “Consumer Credit Deregulation,” the Director General of Fair Trading stated that the objective of the unproclaimed provisions was not to prohibit the offer of mortgage packages, but to facilitate borrowers’ informed choice between packages and free-standing loans and to ensure the continued availability of the latter if borrowers wished to choose them. He noted that the Office of Fair Trading research paper entitled “Packaged Mortgages: Results of Consumer Surveys” added “weight to the view that there may indeed be a certain lack of transparency about the nature of some packaged products and about the availability of free-standing mortgages offered by both lenders and intermediaries, and perhaps also a lack of awareness about them on the part of consumers. There are clearly considerable pressures upon some customers to take tied-in services without their being able, in practice, to assess the value of those services by shopping around.”

The Director General’s recommendation that the provisions be proclaimed has not yet been taken, perhaps because of ongoing consideration about how the mortgage market is to be regulated overall. The government has given the industry two years to apply a self-regulatory mortgage code which includes some anti-tying provisions, although they are considered to fall well short of the approach that consumer organizations are seeking.

Submissions to the Task Force on Tied Selling

The views expressed in the submissions vary from one end of the spectrum to the other. Market intermediaries – such as the Canadian Association of Insurance and Financial Advisors (CAIFA), the Insurance Brokers Association of Canada (IBAC) and independent securities dealers generally call for a complete ban on tied selling. Insurance groups call for the proclamation of section 459.1 of the Bank Act in order to level the playing field and address the significant potential for abuse, given the market power of banks. Insurance intermediaries have argued that even a complete ban on tied selling may not be a sufficient deterrent to tied selling activity in bank branches. In fact, this is one of their major arguments against allowing banks to distribute insurance. They point out the imbalance in power between a consumer and a financial institution, the difficulty consumers may face in unwinding their relationship with one institution and moving to another, and consumer fears of retribution. The Canadian Federation of Independent Business shares these concerns.

The position of the Insurance Bureau of Canada is similar to that of the insurance intermediaries and the independent securities dealers. The Canadian Life and Health Insurance Association submission is silent on the subject of tied selling except for indicating its support for the continued regulation of market conduct at the provincial level.

Banks and trust companies are of the view that market forces, the Competition Act and self-regulation are sufficient safeguards to control coercive tied selling. They suggest that there is little evidence of coercive tied selling in Canada, and that experience in other countries shows that allowing banks to market products, including insurance products, does not create concerns about tied selling. Engaging in tied selling erodes an institution's relationship with its customers. It would be a difficult balancing act to legislate against "harmful" tied selling practices without disrupting existing arrangements that customers consider beneficial. It is argued that small business lending has little economic viability without the potential to draw in personal business as well, and that if tied selling is banned lenders will be forced to evaluate each loan on its merits and profitability rather than on the basis of the collective activity with the customer. The end result could be cost increases and reduced availability of loans for small businesses.

The Director of Investigation and Research of the Competition Bureau is opposed to an outright ban on tied selling unless it is clear that the only motivation for a tied sale is to foreclose competition.[146] In a letter to the Chair of the Task Force dated October 16, 1997, the Director notes:

> ... the ultimate goal of the relevant provisions of the *Act* is to preserve the conditions that allow for competition rather than to simply protect competitors. Generally speaking, the protection of competitors is relevant only to the extent that the participation of these competitors in the market is necessary to keep the prices at competitive levels. The sections of the *Act* dealing with tied selling are therefore aimed at protecting consumers from practices that would leave them with higher prices and less choice. Removal of competitors from a market may reduce competition and harm consumers, but this is not necessarily the case. Tying may reduce competition from suppliers of individual components of the set of tied products. However, when bundling reduces costs and there is sufficient remaining competition among suppliers of the tied products to ensure that these cost savings are passed on to consumers, a prohibition on tying would impose a cost to consumers in the form of higher prices... The Bureau recognizes that there may be other consumer protection issues related to tied selling; for example, the perception by uninformed consumers that no choice exists as an alternative to a particular circumstance of tied selling can effectively restrict the options the

[146] Director of Investigation and Research of The Competition Bureau, Submission to the Task Force, Appendix 1, pp. 1, 2.

> consumer feels are available, thus allowing the supplier to exploit this ignorance by setting higher fees. Efforts that promote consumer education regarding the nature and choices of financial products can go a long way towards ensuring that this sort of uninformed decision-making on the part of consumers is minimized.[147]

The Consumers' Association of Canada did not make a submission to the Task Force on tied selling. In previous submissions on the subject of retailing of insurance by deposit-taking institutions, the CAC has indicated serious concerns about the efficacy of prohibitions on tied selling, but has left the door open to explore formulations of such prohibitions.[148]

Conclusion

Freedom from Coercion

The Task Force starts from a basic premise: all consumers are entitled to expect freedom from coercion from the businesses with which they deal, including financial institutions or other entities which offer financial products or services, regardless of how the products or services are distributed. This is a value choice that should be part of the foundation of the system, not a specifically designed remedy for a particular problem.

The Task Force believes that coercion is the exception and not the rule in the Canadian financial system, but it is also of the view that in today's marketplace and the marketplace of the future, the potential for coercion exists in every part of the sector. A look at provincial provisions suggests that coercion was historically viewed as most likely to arise in situations where intermediaries were being relied on to both give advice and sell products in return for commission-based compensation. Deposit-taking institutions were not seen in the same way because their businesses were transaction-based and advice was not a principal component of the relationship, nor was compensation of the sellers typically commission-based. Now that both suppliers and intermediaries are in more comparable businesses, at least vis-à-vis the retail customer – giving advice and selling products, and often being compensated based on sales and profitability – the application of coercion could happen in either setting.

The Task Force urges that every jurisdiction take steps to unequivocally enshrine the freedom of financial services customers or prospective customers from coercion. Breach of such a provision should constitute an offence or professional misconduct, depending on the regulatory structure. Consideration should also

[147] Attachment to letter dated October 16, 1997 to the Chair of the Task Force from the Director of Investigation and Research of the Competition Bureau.

[148] Letter dated March 31, 1998 from the Consumers' Association of Canada to Chair, House of Commons Finance Committee, a copy of which was forwarded to the Chair of the Task Force.

be given to making civil remedies available to customers, including contract rescission and punitive damages. While the prohibition is necessarily general, it is comparable to provisions that exist in law where society has deemed it to be appropriate to set a standard of behaviour.

Coercion already is prohibited, to a considerable (but not complete) degree in insurance, as indicated by the review of provincial provisions. The tied selling provisions applicable to mutual fund sales in financial institutions also are broadly phrased, incorporating a test based on what a “reasonable person” would perceive. It should be noted that market conduct rules are generally broadly drawn (e.g., prohibitions on “unfair market practices” or the “know your client rule” in securities) as it is impossible to identify all unacceptable practices or circumstances in advance, or for a complex and constantly changing marketplace. They form the basis, if breached, for prosecution. Similarly many basic standards in the law of contract and in the law of tort (negligence, for example) are applied on a case-by-case basis.

A statutory prohibition on coercion will not interfere with a customer’s option to seek redress through the courts, where the case merits such action and the resources for litigation exist. This approach will confirm the high standards that are applied to those who either give advice about, or deal with, other people’s money, and it will assist consumers who seek redress in their unique circumstances by giving some guidance to the decision maker (whether court or ombudsman) of the standard expected.

Importance of Disclosure and Sales Practices

The Task Force observes that the bundling of products and services, with or without price or other incentives, is widespread in Canada’s economy and is an established element in the choices open to consumers. Using tied selling in the neutral sense to describe such arrangements, the Task Force has concluded that tied selling can be beneficial to consumers, but only if consumers are free to make an informed choice from all the options, including the tied sale. The absence of coercion and the availability of timely and full disclosure are both essential to the consumer. To recommend a complete ban on all tied sales of financial services and products would be a vastly over-inclusive measure that is not justified on the basis of the evidence before the Task Force.

The key question, in the Task Force’s view, is whether Canadians can be confident that they are free to make an informed choice from all the options or, if they are not, that they have access to remedies suitable to their circumstances. The Task Force agrees with those who argue that there is inequality of bargaining power between financial institutions and their customers. Although difficulties most frequently may relate to the availability and cost of credit, they are not restricted to those categories given increasing business powers and the uniqueness of customer circumstances. In practice, the gap can be very narrow or very wide, depending on the business approach taken by supplier or intermediary and the circumstances of the customer.

The Task Force does not agree with those who argue that, because the individual customer can choose to go to another supplier or intermediary, the customer needs no other remedy in the face of coercive tied selling. The "choice" has the potential to create costs for the consumer, including penalties for early termination of loans or investment products, which can be substantial. In the Task Force's view, customers should also be able, to the greatest extent possible, to make the choice to purchase products on a different – i.e., untied – basis, and to keep their business with the supplier or intermediary with whom they have been dealing. It is recognized that it may be uneconomic for the supplier or intermediary to offer every product or service on an untied basis. Conversely, it is asserted that it also may be uneconomic for the customer to exercise his or her freedom in every case, which becomes only a freedom to go, not a freedom to stay.

The Task Force has substantial concerns about the disclosure made to customers or prospective customers in the case of tied sales, both with respect to its content and its timing. It is often not clear what is being tied, and what the costs are on a tied and stand-alone basis. It is often not clear whether the products or services are available on a stand-alone basis. In the case of credit, it is often not clear how the tie relates to the security being requested for the loan. Sometimes the taking of security is simply a backdoor way of achieving a tie.

The Task Force believes that Canadians do not have sufficient confidence in their freedom to make choices between the options offered to them. This view is supported by the results of the Ekos public opinion research study, noted earlier, which found that 16 percent of Canadians surveyed felt that, in the last three years, a loan or a mortgage might not have been approved unless another product was purchased from the same institution.

The most effective ways to limit coercive tied selling in the financial services sector in Canada are the implementation of "best" disclosure and sales practices by suppliers and intermediaries, and consumer participation and responsibility. All suppliers and intermediaries should ensure, as a matter of corporate governance, that every salesperson is trained in best practices designed to avoid coercion of any type, including coercive tied selling. This is not a make-work recommendation: the position of the whole sector suffers from public views about how it deals with its customers.

Existing Approaches

The Task Force has considered the positions of those who argue that the common-law restraint of trade and the provisions of the Competition Act (Canada) are sufficient protection for consumers against coercive tied selling. This is a position founded in theory: there have been no tied selling cases in Canada decided under either, and so it is difficult to assess their effectiveness. Neither remedy is realistically accessible to consumers. The cost and time frame of private litigation justify it only in certain cases, assuming that the resources to commence litigation exist at all. In the case of the Competition Act, while it does not doubt the wisdom of provisions which govern the level of tied selling in a market, the Task Force does not agree that these provisions either set a standard for the treatment of individual consumers or put access to a remedy in the hands of consumers.

The Task Force has considered the role of voluntary self-regulation, that is, regulation which is not derived from a statutory requirement. The Task Force considers voluntary self-regulation to be an essential part of any initiative to limit coercion and coercive tied selling as it may be the only way to embed best practices in an organization. In that sense, progress made to date by organizations such as the Canadian Bankers Association and the Canadian Life and Health Insurance Association are acknowledged and approved. Voluntary self-regulation, however, is not sufficient in this case as it cannot adequately address either the perception of consumers or their position vis-à-vis the power of institutions.

Statutory Rules for Financial Institutions

The Task Force urges a three-pronged approach to address the occurrence of coercive tied selling. First, the Task Force argues that a provision equivalent to 459.1 of the Bank Act, with modifications described below, should be proclaimed and come into force for all federal financial institutions as soon as possible. Second, the Task Force urges that financial institutions be required, by statute, to notify a customer entering into a transaction of a type covered by the provision (where the tying product is credit or insurance, or any other tying product designated by regulation as provided below) that coercion and coercive tied selling are prohibited by law. Third, the Task Force urges that customers who allege that they have been coerced be given access to civil remedies for breach of the statutory provisions. Each of these proposals is described below.

Prohibition on Coercive Tied Selling of any Products or Services of Federal Financial Institutions

The Task Force notes that section 459.1, as proposed, addresses the situation where a loan is the tying product. This provision would not apply if the tying product were something different, for instance, a credit card or credit insurance. In addition, the existing significantly limited formulation is not suitable if the provision is to be applied to all federal financial institutions as products and services vary. It must be remembered that section 459.1, like provincial provisions on tied selling, does not constitute a complete ban on tied selling but instead prohibits coercion in the sale of products which are tied. In the Task Force's view, therefore, the provision should be expanded to include insurance and other credit products sold by the institution. Subsections (2) and (3) of section 459.1 require a similar expansion.

The Task Force also suggests that there should be additional statutory authority to designate, by regulations, other specific products or services to which the coercive tied selling provisions would apply. This would ensure that flexibility exists in the regulatory system to respond to unacceptable marketplace practices in a comprehensive way.

Disclosure

Further, the Task Force urges that suppliers and intermediaries make every effort, in cases where products are tied, and it is commercially reasonable, to itemize and price the different components in a package so that comparisons to stand-alone products and other combinations can be made by consumers and savings, if any, can be estimated. This information should be provided to customers or potential customers before they enter into any contracts relating to the tied sale.

The Task Force proposes that financial institutions and intermediaries be required by law to notify every customer in writing, prior to entering into any contract of the type covered by the anti-tying provisions (initially, credit and insurance, and subsequently as expanded by regulation) that coercion and coercive tied selling are not legal. The Task Force urges government to work with consumer groups and industry to develop a common, easily understood statement that can be generally used by all institutions and intermediaries.

Remedies

The Task Force proposes that coercive tied selling constitute an offence as it is intended that this will emphasize to front-line sales forces how unacceptable coercive tied selling is to the public. Consideration should be given to remedies that can be pursued by the consumer. For instance, customers could have the right to rescind any contract which they were required to enter into within a short period after the sale, without any cost or penalty. Consideration should also be given to allowing customers to bring private actions for punitive damages against entities which have required them to enter into tied sales in contravention of the statutory rules. It is expected that consumers will have access to an ombudsman system if they choose to file a complaint in cases of coercive tied selling. The proposed statutory scheme will provide a basis for establishing the nature of the conduct expected of sellers by the ombudsman.

Chapter 6

Redress

Consumers have a multitude of interactions with financial institutions. The interactions may start well before, and go well beyond, the act of entering into a formal legal relationship (if that is done at all). This chapter considers how consumers achieve redress when it is needed in these relationships. Redress is a broad concept which encompasses substantive rights, enforcement mechanisms and remedies, as well as all related procedural elements.

To emphasize redress is not to suggest that consumers should lack confidence in Canada's financial sector. The need for effective redress arises in Canada and other countries from the sheer volume of activity, as observed by James Brown in referring to the experience in the United States:

> The overwhelming majority of consumer financial services transactions in the United States are (and historically have been) handled relatively smoothly, without confusion or complaint, typically resulting in the mutually beneficial ends contemplated and desired by both provider and consumer ... as routine consumer financial services have become increasingly mechanized – with the resultant declining per transaction margins – the economic pressures on service providers to prevent relatively costly redress or inquiry situations increase. But, inevitably, with literally tens of billions of such transactions occurring annually – and with a proliferation of new and unfamiliar financial products and services being offered to consumers – even a small fraction of such transactions involving confusion or claims of unfair treatment inexorably lead to relatively large numbers of inquiries or disputes.[149]

By way of illustration, 9 percent of the people surveyed by Ekos Research Associates for the Task Force indicated that in the past year they had had a serious problem with the financial institution where they did their banking. In the case of their insurance company or broker, the comparable response was 7 percent.[150]

Effective and efficient redress systems are a sign of a well-functioning marketplace as they bring benefits to both consumers and providers. The availability of redress produces multiple results. It can be remedial, offering a remedy to a

[149] Brown, *Achieving Redress: Handling Inquiries and Disputes in Common Financial Services Transactions in the United States*, p. 181.

[150] Ekos, op. cit., p. 31, 35.

person who has been harmed or dealt with in an unacceptable way. Less obvious, but equally important, is the benefit noted by Kerton:

> ... redress performs an indispensable economic function by allocating greater market shares to firms with superior services. In particular, when redress is fully applied it creates special expenses for those who market lemons. A framework for the financial sector that neglects this factor is inadequate: it is unfair to consumers and superior sellers alike.[151]

Finally, it can have a preventative effect, diminishing the risk of similar treatment for others.

The Task Force has an orientation in considering redress. Of particular interest are ombudsman systems which are readily understood and usable by consumers themselves. This is not to say that these should be the only redress measures, but the Task Force considers it essential that consumers have some form of direct redress available to them.

The Importance of Redress

For the vast majority of people in Canada, day-to-day use of financial products and services is a necessity. Although consumers can and should approach relationships with suppliers with diligence and judgment, in both theory and practice it is unlikely that they can know as much about a product or service (and the products or services of competitors), as the financial institution or financial intermediary selling the product or service. This applies to all the characteristics of a product or service – features, risk and price. As consumers are diverse in their backgrounds, objectives and capacities, the size of the gap in information and understanding can be narrow or wide through no failure on the part of the consumer and no ill intent on the part of the financial institution or intermediary. This gap will widen as the consumer is less able, or less willing, to take the steps necessary to make an informed choice, or as the seller tries to take advantage of the consumer.

Just as the information gap can be made narrower or wider by consumer actions, it can be made wider or narrower by the actions of the person selling the product or service or dealing with a consumer in any other pre- or post-transaction situation. While business may be conducted in the name of a particular institution or other supplier, selling is done person-to-person. Sellers vary enormously in their training, knowledge, experience, attitude and technique. Interactions which occur through the use of technology, while offering

[151] Kerton, *Principles of Transparency and Redress as Components of Consumer Protection Policy,* op. cit., p. 23.

standard information and occurring in a formatted way, by definition present only limited information or limited options in the actual transaction.

Not only can consumers not know as much about a product or service as the entity assembling it or marketing it, but they generally do not participate in creating the agreements or contracts. As stated by James Brown in research commissioned by the Task Force, agreements or contracts "are written by the financial services provider and in no meaningful way reflect anything approaching a real or equitable bargaining or balancing of interests between provider and consumer."[152] A consumer who is not satisfied with a proposed agreement or contract can go to another institution or intermediary, but that does not change the reality that, in the Canadian context at least, in each case these documents are by and large developed by one party to the transaction.

In addition to a systemic information gap, there is a resource gap: consumers, particularly individual and small business consumers, simply do not have the resources available to financial institutions and intermediaries. Financial institutions and intermediaries have extensive access to staff, expert advisers, time and money at levels which can be matched by customers only in exceptional circumstances.

The inequalities which exist in theory and in practice between consumers on the one hand, and institutions and intermediaries on the other, are not unique to the financial services sector, although they may be more significant or more problematic in that sector as compared to others. As convergence and consolidation in the sector increase, financial institutions will be even bigger, with bigger product lines and greater challenges in training and monitoring staff.

Although consumers have had, and continue to have, access to the courts to assert rights based on general legal principles, this access has been seen as not sufficient for a number of reasons. Two of the most important are the following:

- there are limits on the rights and remedies available through the courts, and many consumer situations do not fit into these boundaries; and
- the expense of litigation is justified only in more serious cases or where the consumer has substantial resources to dedicate to the case.

Other forms of redress – for instance, prosecution for statutory offences and professional disciplinary proceedings for market intermediaries – present few straightforward and remedial opportunities to consumers in normal circumstances. The ombudsman model, which grew out of market regulation from an expressly consumer perspective and has evolved into a consumer-friendly

[152] Brown, *Achieving Redress: Handling Inquires and Disputes in Common Financial Services Transactions in the United States,* p. 183.

mediation and conciliation system for consumer complaints, offers the most promise for efficient and accessible consumer redress.

Current Consumer Complaint Assistance in Canada

Provincial Regulatory Assistance

Provincial regulators of trust companies, credit unions and caisses populaires, and insurance companies have long provided structured complaints-handling assistance to consumers on an informal, non-statutory basis. Complaints about banks would be referred to federal authorities unless there was some connection with provincial regulation. Although regulators are perceived as knowledgeable and neutral, independent of any company or industry entity, most in Canada are primarily focussed on solvency regulation and have a limited capacity to participate in the resolution of consumer complaints.

Consumers also often go to regulators for information when they are dissatisfied with their treatment, because regulators may be easier to identify and find than industry-based services, and are more affordable than seeking legal or other professional advice. Regulators may be the last resort in a contentious matter, or consumers may feel that public authorities need to know about the treatment they have received so that regulatory action or other appropriate steps can be taken.

Regulators will often direct consumers to services pertinent to the matter. These may include in-house company services, industry information and complaint bureaus, other government departments or professional bodies. Regulators will sometimes engage in the matter, particularly where a company or an intermediary appears to be in breach of the letter or spirit of the law. In such instances, they typically use their moral suasion powers, which derive from their status as regulators, rather than actual, delegated redress powers. They will sometimes incorporate a concern about marketplace conduct into a regulatory audit, or they may refer the matter to the appropriate investigation or prosecutorial office if it appears an offence may have been committed.

Ontario amended its Insurance Act in 1996 to establish the office of the Insurance Ombudsman, whose job is to inquire into complaints about all insurers' business practices.[153] This office is separate and distinct from the mediation and arbitration system operating for no-fault automobile insurance claims. The Insurance Ombudsman is an employee of the newly created Financial Services Commission of Ontario (which includes the former Ontario Insurance Commission), and the office is part of that agency. The Insurance Ombudsman's mandate may be broadened to cover trust and loan companies,

[153] Insurance Act, R.S.O. 1990, c. I.8, s. 5.1.

as well as pensions. The Insurance Ombudsman was not given procedural or remedial powers and therefore presumably is operating on a moral suasion basis. Under this system, each insurance company which carries on business in the province must have a Complaint Handling Protocol. Each company has been asked to appoint a senior-level executive acting as company ombudsman to deal with complaints. Consumers with complaints go to the company ombudsman first and, if the complaint is not resolved to the consumer's satisfaction, the consumer may then choose to go to the Insurance Ombudsman. The Insurance Ombudsman may attempt to resolve the complaint, or may recommend that the Superintendent of Insurance inquire into the complaint.

Staff of the Task Force contacted provincial regulators in early 1998 to determine the nature of consumer concerns reported to their offices. Most responded, although most do not compile the information statistically. Many consumer complaints received by provincial regulators relate to disputes about insurance claims (both property and life/health products), and about account debits, service charges, credit collections, the terms of locked-in products and contract disclosure generally. Many also arise from privacy issues and sales practices, including tied selling (e.g., of creditor life insurance on a loan), or from slow transfer of registered retirement saving plan (RRSP) balances where the consumer has decided to change providers.

Federal Regulatory Assistance

The Office of the Superintendent of Financial Institutions also performs consumer advisory and complaints-handling functions.

In 1992, the legislation applicable to federally regulated financial institutions was amended to include a requirement that financial institutions establish and follow specific procedures for handling consumer complaints.[154] As part of these procedures, each institution must designate an officer or employee to be responsible for implementing them, as well as one or more officers or employees to receive and deal with complaints. The procedures must be readily available to customers and must include information on how to contact OSFI. OSFI is required to report on these procedures and complaints received in its annual report.

Consumers may contact OSFI in writing, on a toll-free telephone line, or through its Web site (use of the last is increasing rapidly). For the year ended March 31, 1997, out of just over 13,000 inquiries, OSFI received 3,600 complaints. Of the 3,093 complaints relating to contracts and their sale, most concerned either credit collections or insurance claims (reflecting provincial

[154] Bank Act, op. cit., ss. 455 and 456; Trust and Loan Companies Act, op. cit., ss. 441 and 442; Insurance Companies Act, op. cit., ss. 486 and 487 and related regulations.

experience), but they also included complaints about privacy and tied selling. Enquiries or complaints which are specific in nature or related to a specific institution generally are referred to the relevant body or institution.

Exhibit 6.1
OSFI Complaints and Enquiries
April 1, 1996 to March 31, 1997

	Banks	Trust	Life	P&C	Pensions	Other	Total
Enquiries							
General	2,131	384	577	344	334	1,818	5,588
Specific	973	139	250	158	493	2,084	4,097
Complaints							
Cost of Borrowing	36	0	0	0	0	2	38
Service Charges	137	18	0	0	0	5	160
Quality of Service	128	11	3	1	0	1	144
Small Business	108	2	0	0	0	0	110
Legal/Contractual/Products	2,313	259	271	131	3	116	3,093
Floating Issues	13	9	21	10	0	1	54
Total	5,839	822	1,122	644	830	4,027	13,284

Source: Office of the Superintendent of Financial Institutions, Annual Report 1996-97 p. 29.

Industry Ombudsman Initiatives

Canadian financial institutions, intermediaries, trade associations and self-regulatory bodies have been, are and will continue to be in the business of satisfying customers, and therefore to varying degrees are involved in receiving and addressing consumer complaints. Some have established procedures (e.g., toll-free lines, designated officials); others deal with complaints in a more ad hoc fashion. Although increased competition for customers and higher consumer expectations about service have resulted in greater efforts by business to take consumer redress mechanisms more seriously, it is difficult to ascertain the accessibility, consistency, effectiveness and efficiency of what may be offered.

Historically, consumer services offered by industry have put the greatest emphasis on providing information, although the services offered are expanding to meet additional needs. The Consumer Assistance Centre of the CLHIA, for instance, has been in existence for 25 years and it has been actively involved in resolving consumer complaints using a pool of people knowledgeable in the industry.

It should be noted that financial sector contracts generally do not incorporate access to a particular redress mechanism. Arbitration is sometimes available to retail customers in standard-form contracts – for instance, in resolving disputes about property damage to automobiles – but generally it is available only in large commercial transactions where the redress mechanism is negotiated by the parties to the specific transaction.

Canadian Banking Ombudsman

On July 1, 1996, Canada's banks launched a voluntary redress system based on the ombudsman model. According to the Canadian Bankers Association, it "was created as a result of extensive positive dialogue involving the Canadian banking industry, government officials and parliamentarians, specifically those on the House of Commons Committee on Industry. Its founding was the culmination of several banking industry initiatives aimed at improving the relationship between banks and their small business customers, including a code of conduct that clearly outlines policies regarding the banks' relationships with small business customers."[155] Personal banking customers were added in March 1997. Twelve banks (including the six largest in Canada) were participating as of March 1998.

The ombudsman concept has been borrowed from Scandinavia where ombudsman offices were created, separate and apart from safety and soundness regulators, to focus on the needs of consumers and to work for improved consumer treatment in the marketplace generally, on the basis of fairness and fair play. In Scandinavia, however, the ombudsmen are essentially dedicated market conduct regulators; they do not consider individual complaints, but instead concern themselves with the operation of the market in the best interests of consumers. In the ombudsman model used by the banks in Canada and elsewhere (described in more detail below), a person is given responsibility for resolving *individual* consumer complaints based on fairness and fair play, using consumer-friendly processes.

Each participating bank has appointed an internal bank ombudsman who attempts to resolve complaints from individual and small business customers of that bank or any of its subsidiaries (trust, investment or insurance company, etc.). The regime does not yet have a firm definition of what constitutes a "small business": the Canadian Banking Ombudsman looks at the circumstances in each case. If the complaint is not resolved to the satisfaction of the customer, or if the internal bank ombudsman does not achieve a resolution within a specified number of days, the customer may appeal to the Canadian Banking Ombudsman. ("CBO" refers to the office, while "Ombudsman" refers to the person with the responsibility for handling complaints.)

The CBO has a mandate to deal with any maladministration, defined by the CBO's Terms of Reference to be "an act or omission in breach of any obligations or duty owed by a participating bank for banking services between that bank and its individual and small business customers." The CBO cannot investigate complaints about the general pricing of products and services (e.g., interest rates,

[155] Canadian Bankers Association, submission to the Task Force, p. 37.

service charges, credit card charges), the credit-granting policies of the banks, or issues that are or have been before the courts. As a result, the CBO can investigate only complaints about the maladministration of these matters.

Banking ombudsman services, including those of the CBO, are provided free of charge to the user. Every effort is made to serve complainants in their own language.

The CBO describes itself as "an independent organization" whose "goal is to provide fair, impartial and prompt resolution of complaints, according to good business and banking practices."[156] The Ombudsman is directed by the CBO's Terms of Reference to seek a resolution that is satisfactory to the complainant. Complaints may be settled or withdrawn, or the Ombudsman may make a recommendation in writing, in which case the Ombudsman must provide reasons.

In a case where there has been some loss, damage or inconvenience suffered by the complainant, the Ombudsman may recommend compensation "appropriate to compensate the complainant for direct loss or damage suffered."

The participating banks are not bound by the Ombudsman's recommendations, although to date all have been implemented. The Ombudsman is required to report publicly the name of any bank which does not comply with a recommendation. The Ombudsman must also report publicly the number of complaints brought to the CBO against each branch, the results and the time taken. Similarly, a complainant is not bound by the recommendation of the Ombudsman. The complainant may proceed to the courts if not satisfied, although no part of the Ombudsman's proceedings can be used in a subsequent legal action.

The Ombudsman has overall responsibility for the conduct of the Ombudsman's office and, in particular, decides on the procedures to be used by the office in receiving and considering complaints.

The CBO's Annual Report for the year ended October 31, 1997, states that 424 complaints from individuals were received (the CBO started taking such complaints on March 1, 1997). According to the Ombudsman's assessment of the complainant's reaction, agreement was reached in 31 percent of the cases, partial resolution was achieved in 23 percent and no agreement was reached in 46 percent. In the cases where the Ombudsman made a recommendation, 40 percent were in favour of the customer, and in 60 percent the bank's action was found to be appropriate. In the case of complaints from small businesses, 182 were received; agreement is considered to have been reached in 34 percent, partial agreement in 13 percent and no agreement in 53 percent. In cases where

[156] Canadian Banking Ombudsman, *Annual Report 1997*, p. 2.

the Ombudsman made a recommendation, 41 percent were in favour of the customer and 59 percent were in favour of the bank. Highest on the list of subjects of complaint for both types of consumers were accounts and transactions; credit collections; card services; fees and charges; new or changed terms for credit; and service and advice. Privacy, tied selling and other selling practices were lower.[157]

The CBO, which is funded by its member banks based on their asset size, is governed by a board of directors composed of six members independent of the participating banks (they are elected for a three-year term and may be re-elected) and five senior bank executives. The board does not play any role with respect to complaints as the Ombudsman does not solicit advice from, nor report to, the board on individual complaints.

The board is chaired by an independent director. The independent directors act as a committee of the board and have been granted special powers to safeguard the independence of the Ombudsman. The board may not dismiss the Ombudsman without the unanimous approval of the independent directors. The independent directors also review and recommend candidates for Ombudsman, the appointment being made by the full board. They act as the nominating committee for candidates for the independent director positions. They review the budget and recommend it to the board. The CBO did not have this structure when it commenced operations in July 1996; the board made significant changes in its first year of operation to increase the independence of the Ombudsman and to establish public confidence.

Member banks and the CBO have initiatives under way to increase awareness of the process. The board is open to expanding the CBO to include other types of financial institutions, and the Ombudsman is actively inviting them to join the CBO. At that point it would become a broader financial services ombudsman, with appropriate modifications to its structure and terms of reference. There is no indication of whether the CBO will be able to expand in this way.

The CLHIA announced in May 1998 that it will be providing a new OmbudService through a separate division of its Consumer Assistance Centre effective September 1, 1998. The CLHIA estimates that about 1,000 of the 75,000 calls its Consumer Assistance Centre receives each year are complaints. Currently, the Centre provides information or directs concerns to appropriate company officers. In the future, the ombudsmen will be drawn from a pool of persons knowledgeable about the industry who have received training in alternate dispute resolution techniques and, if both parties agree, will be available for conciliation of complaints.[158]

[157] CBO, op. cit., pp. 6, 7.

[158] Canadian Life and Health Insurance Association, News Release, May 20, 1998.

International Comparisons

This section reviews redress mechanisms which are designed to be used by consumers directly to achieve satisfaction and, where appropriate, specific remedies in jurisdictions with a financial sector generally comparable to Canada's. Such mechanisms can elucidate and challenge our thinking but they do not necessarily provide a template which can be copied in Canada. As James Brown notes, what has happened in each country is unique to that country's cultural, political, demographic and legal circumstances.[159]

United States

Apart from the inclusion of arbitration rights in some types of contracts (principally securities and, to a lesser extent, property and casualty insurance contracts), privately created forms of legal redress have not been used in the United States. The principal reason for their rejection has been that they are seen as favouring providers to an unacceptable degree. Brown states:

> ... they have been broadly attacked as generally lacking in public credibility (and thus political feasibility), primarily due to the fact that financial services contracts and agreements are generally seen, and as a result criticized, by consumer representatives and by much of the public as functionally being contracts of adhesion. That is to say, they are written by the financial services provider and in no meaningful way reflect anything approaching a real or equitable bargaining or balancing of interests between provider and consumer.[160]

As a result, in the United States credibility can be established only where there is an oversight mechanism which is seen as being "both independent in outlook and vigorous in policing the even-handedness of any such system."[161] The oversight system in the United States has "generally entailed *governmentally-established* substantive standards, coupled with the potential for private sector enforcement, most commonly through litigation."[162]

United Kingdom

In 1997, the United Kingdom launched a fundamental and far-reaching overhaul of the regulatory structure for the financial services sector. The existing regulatory functions of nine different bodies (including those governing insurance, investment management, credit unions, securities and derivatives business, and banks) are being combined into the Financial Services Authority

159 Brown, *Achieving Redress: Handling Inquires and Disputes in Common Financial Services Transactions in the United States*, op. cit., p. 186.

160 Ibid., p. 183.

161 Ibid., p. 185.

162 Ibid., p. 186.

(FSA). One of the key statutory objectives of the FSA will be to protect consumers. The government has issued a consultation paper titled "Consumer Complaints" which it opens by stating, "Effective procedures for handling complaints about FSA authorized firms will have a key role to play in achieving that objective."[163]

The current situation in the United Kingdom is quite different from that in Canada. There are eight established schemes for handling complaints, one for each separate type of business activity. Four schemes have been established by regulators (including the Personal Investment Authority Ombudsman Bureau) and four are industry-led (including the Banking Ombudsman, the Insurance Ombudsman for property and casualty insurance, and the Personal Insurance Arbitration Service). Only one is based on statutory provisions. Credit unions are not covered by any scheme.

In the case of the schemes established by regulators, governance is usually effected through the board of the regulator. The industry schemes generally have a two-tier structure comprising a board whose members are drawn from the industry to deal with budgeting and fees, and a council with representatives of the interested constituencies (including consumers), which appoints the ombudsman, establishes terms of reference and monitors operations.

The schemes most relevant to the Canadian situation are the Personal Investment Authority Ombudsman Bureau, the Banking Ombudsman, the Insurance Ombudsman and the Personal Insurance Arbitration Service. Membership in the first is compulsory for regulated business and voluntary for unregulated business. Membership in the others is voluntary, except where investment business is involved, in which case all must belong to the Personal Insurance Arbitration Service (life and health). It can be seen that, reflecting business powers and the marketplace, the schemes are not entirely pillar-based and one institution may be in more than one scheme depending on its lines of business.

The schemes do have a number of characteristics in common if one looks at a high level, although there are many differences in detail. The focus in each of the schemes is on private individuals, although the Banking Ombudsman covers partnerships, unincorporated bodies and small companies with an annual turnover of fees of less than £1 million. In all cases, there is an obligation on member firms to attempt to resolve the complaint. If that fails, complainants have access to a third-party ombudsman whose decision is binding on the firm, although not on the consumer. Access to the ombudsman is free of charge (the costs of the system are paid by the members in the form of fees and/or case

163 Financial Services Authority (U.K.), Consumer Complaints (1997), p. 3.

levies). Awards generally are in the ombudsman's discretion, taking into account what is fair in all the circumstances. Payments can be made for distress or inconvenience. There is a cap on awards.

The U.K. government has recently decided that there will be a single scheme in place of the current eight, that it will be an ombudsman scheme, and that membership in the scheme will be compulsory for firms which are authorized by the FSA. It emphasizes the importance of having firms continue to be responsible for dealing with complaints. Jeremy Mitchell, in a research paper undertaken for the Task Force, confirms that this scheme is in accord with the general consensus.[164] Although the government observes that each system in the United Kingdom performs well, there is complexity for consumers, and the inception of the new regulatory system creates an opportunity to tackle the issues more fundamentally. The consultation paper lists the benefits of this approach:

> The main attractions from a consumer perspective would be those of simplicity, accessibility and consistency. Consumers would deal with what was visibly a single ombudsman service, with only one entry point for all complaints, so that once the complaint had been submitted, it would be allocated to the relevant department. From the scheme's point of view it would be possible to deal much more satisfactorily with cases involving more than one type of firm, since the service would span the various jurisdictions which are currently distinct and separate.[165]

It is interesting to note that the government rejected a binding arbitration scheme. It was considered a strength of the ombudsman model that firms can be bound while the complainant can be left free to proceed to court. Further, there is the basis on which awards can be made:

> An arbitrator's award is normally based on the legal rights and duties of the parties to the dispute. Ombudsmen are able to base their judgements on what is "fair and reasonable in the circumstances." This allows them to go beyond the strict legal position and take account of codes of conduct and general standards of good industry practice, as well as the specific conduct of business rules to which a firm may be subject. Ombudsmen are not generally bound by previous decisions or rules of evidence.[166]

The government also has decided that the new ombudsman must be capable of making a binding award against a firm where a complaint has been upheld and other means of reaching a settlement have failed. It observes that this triggers

[164] Jeremy *Mitchell, Financial Services and Consumer Protection: Policy and Practice in the United Kingdom*, op. cit., p. 143.

[165] Financial Services Authority, op. cit., p. 12.

[166] Financial Services Authority, op. cit., p. 15.

significant natural justice issues – meaning that the overall process would have to include a stage or stages where:

- the parties would have the right to have the proceedings conducted in public;
- the parties could be legally represented if they so wished; and
- where appropriate, witnesses could be called and would be open to cross-examination, and the decision would be published, with reasons.

The government proposes to build these safeguards into the ombudsman's internal procedures, rather than allow an appeals process. The government's view is that, as few cases reach the award stage, the requirements will not undermine other goals, including simplicity, accessibility and speed.

The government proposes that the ombudsman be accountable to its own board, separate from the FSA, as this is the best way of ensuring independence. Its chair would be appointed by the FSA with the approval of the Treasury. The members would be appointed by the FSA alone, in the public interest and blending industry experience and a wider consumer interest. Although the FSA would remain responsible for the rules of the scheme, the board would be responsible for all other matters.

Overall, Jeremy Mitchell observes of the U.K. experience:

> There can be little doubt that financial services ombudsmen schemes have brought considerable benefits to many consumers, who would otherwise have little or no chance of getting their complaints heard, let alone any compensation. The sectors of the industry have also benefited, not only in terms of their public image but also in sharpened focus on internal complaints procedures within financial services organizations.[167]

Australia

Australia has experienced a process of developing alternative dispute regimes similar to that in the United Kingdom. It started with the establishment of the Australian Banking Industry Ombudsman in 1989, and there are now seven industry ombudsmen.[168] They grew in response to pressure from consumers and regulators after deregulation of Australia's financial services sector. Kell notes that they have provided cheaper dispute resolution for consumers, and contributed to improved industry standards, although some system-wide problems exist.[169]

[167] Mitchell, *Financial Services and Consumer Protection: Policy and Practice in the United Kingdom*, op. cit., p. 141.

[168] Kell, op. cit., p. 209.

[169] Ibid., op.cit., pp. 209 and 217-219

The Australian Consumers Association favours rationalization of some of the schemes (three handle home mortgages, depending on the institution). The Wallis Inquiry recommended a “single gateway” to access the schemes; indeed, the Finance Complaints Referral Centre commenced operation in February 1998.[170] Small businesses could not access a number of schemes (including the banking ombudsman), and this is being changed.[171]

Kell observes that accountability of the industry schemes remains a problem which will require more vigilance by the regulator. Consumer representatives can become isolated, and systemic complaints do not fit into the schemes.[172]

Other Comparisons

Although in some countries (e.g., France, Germany) the bulk of complaint resolution is left to the financial institutions themselves, with whatever judicial recourse is available if the complaint is not resolved to the retail customer’s satisfaction, the ombudsman model is widespread in other industrialized countries for both banking and insurance. Ireland has an ombudsman scheme for banks which is very similar to that in the United Kingdom.

In some jurisdictions, there is a recognition or registration scheme. For instance, the Netherlands government, through the Foundation for Dispute Settlement (SGR), has prescribed conditions for recognition and the powers of each dispute settlement committee. In Denmark, there are appeal tribunals (dealing with banks, mortgages, and insurance) which are established pursuant to statute but which are basically private. Even in these circumstances the schemes are usually voluntary, although participation rates may be high.

The Netherlands and the Scandinavian countries utilize a tripartite model with independent members, consumer representatives and industry representatives sitting to hear complaints. In other jurisdictions, there is a single ombudsman. Access is not necessarily free, although in some cases no fees are payable if the complainant is successful.

In both the Netherlands and Denmark the decisions are binding on the institution, and in the Netherlands on the complainant as well. As is the case in the United Kingdom, the decisions are not necessarily made public. In many countries, decisions are not binding on any party.

[170] Kell, op. cit., pp. 217, 218

[171] Ibid., p. 219

[172] Ibid.

Submissions to the Task Force on Redress

To the extent that the submissions comment on redress mechanisms, the focus is on the existing ombudsman model, specifically the Canadian Banking Ombudsman. The Canadian Bankers Association and individual banks are of the view that the CBO is structured and working effectively, and that it should be extended to all financial services providers dealing with small and medium-sized enterprises (SMEs) and retail consumers.[173] The financial institutions not currently participating in the CBO do not think that the ombudsman model should be extended to them.[174] The Canadian Federation of Independent Business has called for the scope of the ombudsman mandate to be extended to credit decisions.[175]

The Canadian Community Reinvestment Coalition (CCRC) concentrates its recommendations on the need for a fully independent banking ombudsman with binding decision-making and remedial powers.[176] CCRC put forward the following criticisms of the bank ombudsman system in Canada (it must be noted that the CCRC reviewed the scheme as it existed at the date of its submission):

- Each bank's internal ombudsman and the Canadian Banking Ombudsman are salaried employees of the banks and the Canadian Bankers Association respectively. The board to which the Canadian Banking Ombudsman reported at the date of the CCRC submission (five bankers, five independent directors), is appointed by the banks.[177] As a result, the ombudsman is not independent, with the implication that complainants cannot be confident of impartiality.
- The banks have not "systematically notified" their customers of the ombudsman system. The CCRC recommends elsewhere that each bank customer be notified by mail of complaint procedures and the ombudsman system.
- A complainant must go through the individual bank system completely before making a complaint to the Canadian Banking Ombudsman.
- A complainant must agree in advance and in writing that any information arising from the Canadian Banking Ombudsman's consideration of the complaint or its results cannot be used in any legal action, and the Ombudsman cannot be called as a witness in any legal action.
- No ruling is binding on a bank.

173 Canadian Bankers Association, Submission to the Task Force, p. 38.

174 See, for instance, Credit Union Central of Ontario, Submission to the Task Force, p. 14

175 Canadian Federation of Independent Business, op.cit., pp. 15, 17.

176 Canadian Community Reinvestment Coalition, "Banking Ombudsman – Why They Must Be Independent", Submission to the Task Force, Position Paper #1.

177 The board of the CBO currently is comprised of a majority of independent directors, as described earlier.

- The banks are not committed to the process and are engaged in a public relations gesture.

The CCRC recommends that the federal government establish an independent bank ombudsman modelled on the U.K. system. The U.K. system is argued to be much fairer to consumers because the ombudsman is truly independent. This situation is achieved through a two-tier governance system: a council in which the majority of members are independent and a board of bankers, with extensive checks and balances between the two. The Ombudsman reports to and is funded by the council, which in turn receives funding from the banking industry via the board. The U.K. Ombudsman may make a recommendation that is binding on the bank.

The Canadian Banking Ombudsman, on the other hand, is of the opinion that the CBO is successfully assisting customers and that the CBO now (with the changes made) has a governance structure and an operating scope that are equal or superior to any of the other non-statutory, voluntary ombudsman plans which he has reviewed, including the U.K. system. When compared to other plans, the board of directors of the CBO has more authority, the Ombudsman is more secure in the position, and the CBO covers a broader range of bank products and services. The Ombudsman notes both the representativeness of the board of the CBO and its success in expeditiously and continuously improving the CBO's governance and independence.

The CBO includes in its submission an extensive comparison of itself to the bank ombudsmen in the United Kingdom, Australia, and Ireland each of which is an industry self-regulatory entity.[178] Each of these systems has a bank panel composed of all or some portion of the member banks, which elects the board of directors or council (including the independent members on the recommendation of the board/council), elects the chair and ratifies terms of reference and by-laws. Canada's bank panel appears to have the least power, as in other systems (except Australia) the bank panel ratifies the appointment of the Ombudsman, approves the budgets and levies fees on the banks.

In each system, the chair of the board of directors must be an independent member, and independent members constitute the majority of the positions on the board/council. In Canada, only the independent directors may nominate independent directors; in other systems, independent directors are nominated by either the bank panel or the board/council as a whole. In Canada, the board appoints the Ombudsman, whereas in the other jurisdictions the bank panel must ratify the appointment. Similarly, in Canada the board sets the budget, whereas in other jurisdictions the budget must be ratified by the bank panel.

[178] Canadian Banking Ombudsman, Submission to the Task Force, Appendix III.

The terms of employment and compensation of the ombudsman are set by the board/council and the ombudsman reports to the board/council. In Canada, the Ombudsman may be dismissed by the board only with the unanimous agreement of the independent directors; in the other systems, the power rests with the board/council as a whole (Ireland also requires the approval of the board panel).

Each of the ombudsmen uses mediated settlements and formal recommendations, although they have varying powers. In Ireland, a binding award can be made. In the United Kingdom and Australia, the ombudsman may make a binding award, although the bank is not named; in Canada, the Ombudsman cannot make a binding award, but is required to publicize non-compliance and name the bank. Binding awards are the exception to the rule and are rarely used in any jurisdiction having the power. In Canada, the CBO has not needed to publicize non-compliance as the banks have followed all recommendations.

In the United Kingdom and Australia, the ombudsman may consider credit decisions only for reasons of maladministration; in Ireland, the grounds are unfairness, discrimination or maladministration. In Canada, the grounds are restricted to decisions not conforming to the credit policies of the bank. There is no monetary limit for Ombudsman recommendations in Canada, although there is in the other jurisdictions.

All the systems are free to the consumer. In each system, customers are required to deal with bank process and reach a deadlock before the ombudsman will accept the complaint. This does not appear to be a rigid requirement in Canada or the United Kingdom; only in Canada is each member-bank required to have a senior-level dispute resolution executive who is independent of the operating departments of the banks. In each system, banks are required to make dissatisfied customers aware of their right to go to the ombudsman.

The Ombudsman does not recommend that the CBO have the power to issue binding awards. The Ombudsman has not needed this power as the banks have followed his recommendations in every case. He argues that suasion is a powerful and effective tool, as is the responsibility to publish non-compliance, with the name of the bank and a recommendation. The Ombudsman observes: "The present system requires one to document our findings and 'sell' the fairness of the recommendation to both parties. This is a discipline and challenge this office should have." The Ombudsman is also concerned that binding awards would "move the process toward adversarial positions and there is a definite risk that the process would become more legalistic and process-driven."[179] The ombudsman process is intended to give the customer an alternative to litigation.

179 Canadian Banking Ombudsman, Submission to the Task Force, letter dated October 29, 1997, p. 5.

The Ombudsman does recommend the creation of a single, independent ombudsman for the financial services sector. This would provide seamless coverage for consumers of financial services, would minimize consumer confusion, would increase effectiveness for complaints involved in transactions with different types of institutions, and would increase public awareness and independence.

Conclusion

Corporate Interest and Responsibility

The need for redress arises in the relationship between consumer and seller, and that is where the key accountability for redress rests. This accountability should not arise from the fact that it is mandated as part of a formal redress mechanism, however organized. That is, it should not arise simply because the seller was told to do it or made to do it. It should arise from an understanding that it is in the best interests of both parties to the transaction to ensure that customers are treated fairly in transactions, and fairly when there are disputes.

What Robert Kerton has called "defensive marketing" through private redress systems is both a value and a strategic business tool. He notes:

> The surprising fact is the long time it has taken for firms to realize the economic point. Many sellers, indeed most sellers have treated complaints as negative, rather than seeing them as a potential source of competitive advantage. Financial firms are somewhat later than firms in the goods producing sector to seek a competitive edge by means of customer service. In the economics of 'defensive marketing,' it can be more profitable to spend money to retain an unhappy customer than to try to gain a new one. Every bit as important, alert sellers can make product improvements based on information gained through astute complaint management. Complaints and redress matter very much to the country because the expression of complaints, or 'voicing' as it is known, has been shown to be responsible for many of the truly dynamic improvements to an economy and its institutions.[180]

Using the Ekos study as one indicator, it is interesting to note that, of those who had a problem in the last year with the institution with which they did their banking (i.e., with deposit-takers), more than 54 percent of these complaints were not fully resolved and 21 percent of those who had a problem switched institutions. In the case of those who had a problem with their insurance company/broker, 66 percent of complaints were not fully resolved and 31 percent switched institutions.[181]

[180] Kerton, *Principles: Transparency and Redress – Essential Components of Consumer Protection Policy*, op.cit., p. 24.

[181] Ekos, op.cit., pp. 31-36.

There are positive signs that corporate responsibility for redress is better understood, more accepted and being acted upon within individual institutions and by intermediaries. Changes in both values and the redress opportunities and tools available to consumers are acknowledged and applauded. Taking a broad view across the sector, there is a pressing need for these changes to accelerate in terms of pace and quality. Whatever other redress mechanisms are put in place in the private or public sector, they must be built on, and rely on, a solid foundation at the corporate level.

Different Needs, Different Mechanisms

There is no evidence from any jurisdiction that a single form of redress is appropriate or adequate to address every form of market failure. Accepting that, it does not follow that we should be indifferent to the mix of redress mechanisms and how they work together. For instance, it is in the public interest for marketplaces to function with integrity. Marketplace regulation is a necessary part of achieving that objective.

The Canadian norm has been to rely on certification and licensing regimes and standards. Such regimes and standards may be statutory or regulatory in nature but they have a foundation in public law. Breach of the standards results in a quasi-criminal or criminal charge, or in regulatory or disciplinary action. These provisions also constitute a major part of the substantive rights upon which all forms of redress can draw.

In public policy terms, this approach gives some definition to the standards of behaviour expected of all players in the marketplace, and it supports action against those who are operating at the margins of what is acceptable to society at any given time. While such an approach is necessary, it has limitations. It does not cover all aspects of the relationship between consumer and seller. It depends on state action which, particularly in a period of pressure on public resources, will be used sparingly, generally only in the case of obvious or pressing need. It does not provide any compensation or other transactional remedy to the aggrieved individual.

It was beyond the scope of the Task Force to compare the desirability and efficacy of different methods of enforcement of standards with mechanisms being used in other countries. It is noted that very different approaches are taken in various countries, offering Canada an opportunity to consider its objectives and its options. As noted earlier, reliance is placed in the United States on private enforcement of public (statutory) standards. In some parts of Europe, such as in Denmark, codes of conduct in the form of regulatory guidelines are being used.[182] Governments in Canada, to the extent that they are not doing so, should undertake immediate and serious study of these approaches and should consider whether they would be productive in Canada as part of a more general review and renewal of the regulation of marketplace conduct.

It is likely that the best approach is a mix of substantive rights that is more current and articulated than what exists in Canada today. Components of the mix would be:

- unrestricted access to the courts where a consumer wishes to pursue a right based in common or civil law and is in a position to proceed;
- statutory offence provisions addressing behaviour which is criminal or quasi-criminal in nature;
- a limited number of key substantive rights which are critical to the protection of the individual consumer and which can be enforced privately through the courts (some examples are given elsewhere in this paper with respect to privacy and tied selling);
- relevant and up-to-date codes for the standard of marketplace conduct expected of all financial institutions and intermediaries, which are developed in the public interest by all parties concerned, including consumers, and which are applied and enforced through mechanisms having a statutory basis (i.e., whatever form of self-regulation is desirable should be rooted in public law); and
- ready access to an informal forum for redress in situations where the consumer is of the view that he or she has not been treated fairly or in accordance with good business practice and where satisfaction has not been achieved at the corporate level.

The emphasis in the remainder of this chapter will be on the scope, structure and key characteristics of an ombudsman system based on fairness and good business practice. This is a significant area where the Task Force believes that consumer needs are outstripping what is available. The Task Force favours the creation of a single financial sector ombudsman office, with mandatory membership for federally-incorporated financial institutions and voluntary membership for provincially-incorporated financial institutions and unregulated financial institutions.

The Need for a Fair Forum for Consumers

The ombudsman model is prevalent in other jurisdictions for good reason and it has tangible benefits for Canadian consumers compared to the alternatives.

[182] Suzanne Storm, *Aspects of Banking and Financial Services and Consumer Protection in Denmark and Sweden*, p. 103.

In theory, it has the potential to meet each of the following important benchmarks, being:

- quick;
- affordable;
- transparent;
- fair;
- effective;
- user-friendly;
- accessible;
- well-publicized;
- straightforward; and
- professional.

The Task Force is strongly of the view that a financial sector ombudsman office for the sector should be established by legislation. This ombudsman would not undertake an adjudicative function, but would act as a mediator and conciliator of consumer disputes with financial institutions. A single ombudsman system, to which all federal financial institutions and their subsidiaries would be required to belong as a condition of their authorization to carry on business, offers the greatest potential as a general form for redress for consumers. Although it is appreciated that this is what the Canadian Banking Ombudsman is attempting to achieve by inviting other parts of the sector to join a voluntary organization, CBO expansion will take a considerable amount of time to achieve and, even with success, gaps are likely. The same problem exists even within a part of the sector as pillar-based schemes which are voluntary will have gaps (or overlaps, both of which existed in jurisdictions with multiple ombudsmen). For example, only 12 banks now belong to the CBO. Even if gaps are not significant in terms of overall coverage of the market, they can be significant to the individual consumer who has no access to a forum. Overlaps create confusion and add to cost.

The single ombudsman should be structured so that provincially chartered institutions and unregulated financial institutions could belong. This could be on a voluntary basis. Alternatively, provincial statutes could require membership as a condition of licensing the institution. Having both federal and provincial institutions in one redress system would substantially limit consumer confusion and assist in raising awareness of consumer access to the ombudsman.

In practice, there are choices with the ombudsman model which can either add to or detract from its use and impact. The principal ones identified in the submissions to the Task Force and in the international research undertaken at the request of the Task Force are:

- the scope of its mandate;
- the extent to which it is independent, in both fact and perception;
- the threshold for access and cost;
- whether or not its decisions are binding, and the related procedures for handling complaints; and
- its visibility.

We shall review each of these, with the overall objective of enhancing and extending access by consumers in Canada to ombudsman services.

Mandate

One of the strengths of an ombudsman system is the nature of its mandate. Working with the concepts of fairness and good business practices, the ombudsman has a mandate to consider the business relationship between an entity and its customers, excluding the specific risk management decisions of the financial institutions. The concept of "maladministration" is common to all of the ombudsman systems and it appears to have worked well in practice. While generally the ombudsman is directed to consider the application of existing policies and practices to customers, in fact the ombudsman also is in a position to comment, in policy terms, when a policy or practice is unfair or not consistent with good business practices.

It has been noted in a number of contexts in the work of the Task Force that the financial services marketplace is increasingly a single marketplace without rigid division by geographic/political jurisdiction or type of service/product. As the jurisdiction of incorporation or the type of institution becomes less meaningful in determining the nature of the interface with consumers, a single point of entry to the ombudsman service becomes the ideal. This means, at best, a single ombudsman for the marketplace which is comprehensive in its coverage or, less desirable but still of critical value, a single window for separate ombudsmen services which cover all the products and services within a marketplace.

The course of events in the United Kingdom is instructive: the existence of a number of ombudsman services was confusing to the customer and increasingly less productive because of gaps and overlap in coverage. The situation in Canada would be the same if we progressed to the point where each of the former financial sector "pillars" had its own scheme. Where would the consumer go when the complaint was about creditor's life insurance sold by a bank employee and underwritten by an insurer? Where would the consumer go when the complaint was about a bank or a trust company which is the subsidiary of an insurance company? The answer is that it depends, but the burden of sorting it out should not fall on the shoulders of consumers.

Although the establishment of single ombudsmen with a range of varying expertise may be recent, it is worth noting that in most jurisdictions where the ombudsmen appear separate (Netherlands, Denmark, Sweden), they function within an overall sectoral structure. Further, Canada has some characteristics which recommend a single ombudsman. First, an entity with substantial resources and profile will accomplish more for consumers than a number of services, and will be more visible and accessible to consumers. Second, administrative efficiencies will be served. Finally, marketplace expertise will be built, creating a pool of perspective and experience (including statistical and analytical information) which will be available for use in public policy making.

Independence

It is possible for entities in the public or private sector to be independent in decision making. The Canadian Banking Ombudsman, a purely private-sector entity, has made great progress in responding to public concern and to ensuring its independence from its member banks. The challenge, however, is to be perceived as independent. Given the market power of financial institutions and their resources compared to consumers, industry-sponsored redress mechanisms always will be subject to doubts about their independence. The expression of those doubts has a diminishing effect on the work and the authority of the ombudsmen, no matter how excellent they are.

While a public-sector mandate and structure are not a guarantee of excellence, they are essential to the public perception of independence and consumer confidence. This is the direction being taken in the United Kingdom, and it is consistent with experience in the United States (where the substantive rights and remedies are based in statute) and several European ombudsman systems, where the decisions are taken by a tripartite panel (independent chair, representatives of consumers and representatives of industry).

In order to establish confidence in the independence of the ombudsman, a number of structural features are essential. To maximize the public-interest focus of the ombudsman, the entity should report annually to Parliament through the Minister of Finance. The board of directors of the body should be appointed by the Minister of Finance. Statutory direction should be given to the Minister to ensure that the majority of members of the board are independent of the institutions covered by the scheme. Institutional members of the scheme could nominate a slate of directors which would represent their interests, and the Minister would choose appointees from this slate. The majority of independent directors should include individuals with a consumer background and orientation, and any other factors relevant to establishing public confidence. The Minister of Finance should approve the terms of reference of the ombudsman (which would include his or her delegates) on the recommendation of the board of directors.

The board of directors should appoint the ombudsman – the chief executive officer of the organization – and, on the recommendation of the ombudsman, the deputy ombudsmen who would together bring the range of expertise necessary to meet the statutory mandate. The board of directors should also approve the funding arrangements and the budget of the organization.

Access and Cost

Consistent with the reasoning above, access to an ombudsman should be seen as the next step beyond the complaint-handling system of each financial institution, and care should be taken that each registered institution is required by statute to have such a system with an appropriate mandate given its business powers.

The current approach of the Canadian Banking Ombudsman on the question of who has access to the independent mediation forum has much to recommend it. Although the focus is on the retail customer and small business customers, the definition of who has access is a guideline only and the Ombudsman has the discretion to go outside it in a meritorious case. While allowing all customers access seems attractive in principle (even sophisticated clients may have legitimate complaints), access by retail and small business customers is essential.

Although some ombudsman systems levy a charge on the consumer, which is generally refundable if the consumer is successful, this should not be done in the absence of clear evidence that the system is otherwise subject to abuse. The norm is that industry members should bear the cost of a legitimate, efficient redress system as it is a legitimate part of their business. It is noted that some systems distribute the cost using a formula which takes into account both market share and the volume of complaints associated with each institutional member. The assessment mechanism should be designed to mature and change as experience is gained.

Ombudsman Decisions and Procedures

The choice as to whether ombudsman decisions are binding is an important one for it determines how the parties interrelate. It should be remembered that in the case of systems which are binding, the majority are binding only on the financial institution, not on the complainant, who is left free to pursue any other avenue of redress. Whether or not the decision is binding does not alter the requirement that the ombudsman be fair and impartial toward both parties.

The choice about whether or not decisions are binding has a significant impact on accessibility for consumers and on the flexibility, simplicity, promptness and efficiency of the process.

The Task Force is concerned that if decisions were to be binding, the process would become more legalistic than is desirable. The ombudsman would then be required to conduct his review not in the spirit of mediation, but rather by a structured hearing process with many of the usual trappings of the courts. That could entail, for example, the need to have proceedings conducted in public, the legal representation of the parties, the swearing and cross-examination of witnesses, and other traditional procedural assurances of due legal process. Such a system would not satisfy the benchmark goals of the ombudsman system noted earlier.

The Task Force has concluded that binding decisions are neither necessary nor appropriate, particularly in the context of a public system that provides greater comfort with respect to the related issue of the independence of the ombudsman. The Canadian Banking Ombudsman has observed:

> In the Canadian environment, the responsibility to publish is effective. Our experience shows that the power of suasion is a powerful and effective tool. We do not have a problem implementing our recommendations – the banks have followed all of our recommendations. Based on our experience to date, it is unnecessary to adopt a more structured and legalistic process when there is no problem to be solved.[183]

The Task Force's conclusions concerning the need for, and advisability of, binding decisions is based on the expectation that financial institutions will respect the importance of the ombudsman process and will participate within the spirit of the initiative. If that is not the case and institutions pursue actions intended to frustrate or complicate the ombudsman process, then the Task Force views binding decisions as an inevitable outcome. The Task Force is confident that institutions will see the benefits of the type of informal redress system which is proposed, and that they will participate as constructively as they do in the current voluntary arrangements.

There can be no doubt that the ombudsman for financial institutions should be able to make a recommendation public if he or she is of the view that it would be influential or constructive. Recommendations which are not complied with should be made public through the Annual Report and other appropriate means. In each case made public, utmost privacy of the individual complainant should be assured.

Visibility

Public opinion research conducted at the request of the Task Force indicates that less than 20 percent of those surveyed knew about the Canadian Banking Ombudsman.[184] Lack of knowledge was highest among young people and senior citizens. This is not cited as a criticism, as the ombudsman model and

183 Canadian Banking Ombudsman, Submission to the Task Force, letter dated October 29, 1997, p. 5.

184 Ekos, op.cit., p. 32.

the CBO are relatively new in this sector and the CBO is devoting significant resources to increasing awareness. Lack of visibility is also an ongoing challenge for ombudsmen in other parts of the world. It is noted to highlight the critical importance of ensuring that a financial sector ombudsman has a mandate and sufficient resources to create and maintain awareness of its existence and function.

As noted above, financial institutions also have a direct economic interest in ensuring that their complaint resolution mechanisms are visible and accessible. Indeed, minimum performance standards for both the sector ombudsman and financial institution systems should address visibility measures. The Task Force supports increased use of mailings sent by financial institutions (e.g., account statements, billing statements) to periodically inform and remind consumers of when and how to access both institutional ombudsmen and the financial sector ombudsmen.

Chapter 7

Proficiency Standards

Issue

Proficiency standards for market intermediaries (life insurance agents/brokers, general insurance agents/brokers and securities registrants) are established, administered and enforced at the provincial level. Some intermediary activities are largely unregulated (e.g., deposit brokering, financial planning). The Task Force received submissions which question whether existing proficiency standards are adequate in scope and content for the marketplace of today and the future.

In particular:

- Should all market intermediaries be subject to the same basic proficiency requirements?
- Should there be a minimum formal education requirement?
- Should the examination standards to be met by applicants be raised?
- Should there be continuing education requirements?
- Who should be responsible for the oversight of market intermediaries?

Submissions to the Task Force

The Independent Life Insurance Brokers of Canada (ILIBC) is very critical of the proficiency standards in place today. Outside of Quebec, where a high school diploma is required, there is no formal education requirement for life insurance agents or brokers. According to ILIBC, "specialized" training varies from barely adequate (securities and general insurance) to inadequate (mutual funds), to trivial (life insurance).[185] It has recommended that educational standards should be established and harmonized across all jurisdictions and, in particular, all market intermediaries: (1) should be subject to the same basic proficiency requirements, with specialized product/function training to be built on that foundation; (2) must have at least a high school diploma and a two-year course of study at a community college which combines basic and specialized training;

[185] Independent Life Insurance Brokers of Canada, Submission to the Task Force, op. cit., p. 14.

(3) should be subject to higher entry-level licensing requirements (tougher examinations); and (4) should be regulated by a multidisciplinary regulator.[186]

Further, ILIBC recommends that all insurance be sold through licensed agents and that therefore the exemptions from licensing for head office employees who are not compensated on a commission basis, contained in a number of provincial insurance statutes, should be removed. It argues that the manufacture and the distribution of insurance are two distinct activities and life insurers, as manufacturers, should be prohibited from distributing insurance.[187]

In general, all financial institutions and industry trade associations seek increased harmonization of all the rules governing market intermediaries and market conduct in order to enhance market efficiency and cost-effectiveness. They differ significantly, however, as to how this might be done. Insurers and insurance intermediaries want it to continue to be done at the provincial level. Deposit-takers want it done nationally. In any event, these recommendations are generally focussed on the reduction or elimination of differences, not the appropriateness of the standards.

Current Situation

The regulatory landscape is at its most complex for issues relating to market intermediaries.

First, they are regulated at the provincial/territorial level. Regulation of market intermediaries dates from the 1920s and 1930s, and commentators generally describe the licensing of intermediaries (both qualifications and business practices) as an area of "exclusive provincial jurisdiction" in the constitutional sense. Provincial governments have a variety of interests in market intermediaries, apart from constitutional or intergovernmental policy and consumer protection policy. These include economic and community development, as well as labour market policies – since market intermediaries represent a significant percentage of employment within a province, as well as a significant share of desirable employment categories and, often, entry-level jobs for the work force.

Second, intermediaries have historically been regulated by pillar in the case of securities and insurance. Insurance intermediaries have been regulated by product (life and property-casualty) and by their relationship to the consumer (agent or broker), with sometimes two or three different regimes operating in each province depending on the product and relationship.

Third, they are regulated in a variety of models, including direct government regulation, government agency regulation, and several models of self-regulation.

186 ILIBC, op. cit., p. 3, pp. 14-16.

187 Ibid., pp. 5, 6.

Regulators have prescribed a variety of standards, and there is a large group of suppliers of educational materials, courses and professional designations.

Finally, although the statutory definitions of what constitutes undertaking the business of securities or the business of insurance (or for that matter, trust/loan and banking) are very broad, there are also unregulated activities, particularly in the case of deposit brokers and financial planners.

Multi-licensing of market intermediaries is well established in Canada. All provinces allow dual licensing in the case of life insurance and mutual funds, and most allow it more broadly for retailing securities, selling property-casualty insurance, selling real estate and mortgage brokering. Given the explosion of products and options in each pillar, let alone across pillars, the position of today's market intermediaries vis-à-vis the consumer differs greatly from what it was in the past.

Proficiency standards have been subject to periodic upgrades, although such initiatives generally take considerable time and (according to anecdotal evidence) fall short of the ideal, given the range and nature of the multiple and conflicting interests involved. In the case of both property-casualty and life insurance, the last major review also saw the implementation of self-regulation in many jurisdictions.

We are probably at the end of the most recent property-casualty cycle of revision (started in the l980s) and halfway through the most recent life insurance cycle of revision (started in the mid- to late 1980s). In the case of mutual funds, education and proficiency issues were raised in the 1995 report entitled "Recommendations for Regulating Investment Funds in Canada,"[188] and are part of the mix of mutual fund re-regulation issues. By way of example, the report notes that there are four courses available to mutual fund dealers and their sales representatives, and they vary in content, organization and approach.

Although the provinces have started to move to reflect marketplace developments in the design of their regulatory structures (British Columbia, Quebec and Ontario, for instance, have each created a combined regulator for insurance, trust and loan, and credit unions and caisses populaires), only Quebec has indicated a firm intention in Bill 188, assented to June 1998, to introduce a common regime for market intermediaries.

[188] Glorianne Stromberg, "Regulatory Strategies for the Mid-90's: Recommendations for Regulating Investment Funds in Canada" (January 1995), c.15.

Conclusion

Intermediaries must have sufficient knowledge and understanding to justify the confidence that consumers will place in their advice, and they must be able to communicate information and give advice clearly and fully to consumers. The best market conduct rules in the world will not be adequate to protect consumers if intermediaries and other sellers cannot meet adequate standards of competence. There is evidence that, in many cases, both the regulatory standards and the competence of intermediaries fall short of what consumers are entitled to expect.

Distributors of financial products and services play an essential role in the marketplace that is going to continue. They are, and will continue to be, affected by the forces of change operating in the sector. Proficiency of market intermediaries is an important aspect of an effective and efficient market.

The Task Force, consistent with its approach to consumer protection, urges the adoption of adequate proficiency standards for market intermediaries. These should include: (1) a post-secondary educational requirement of a diploma in a relevant and approved program for new applicants; (2) examination standards which reflect the role of market intermediaries and reliance placed on their advice; and (3) enhanced continuing education standards for all licensed individuals. Continuing education standards may need to vary depending on the level of standards in place at the time of licensing.

The Task Force supports the harmonization of proficiency standards to the greatest extent possible across all jurisdictions.

The Task Force supports the implementation of provincial regulation of market intermediaries by a single regulator, given both marketplace characteristics and consumer interests.

Finally, the Task Force supports provincial review of: (1) the current exemptions from provincial licensing requirements to determine whether those who benefit from the exemptions have training and supervision that are truly equivalent to the standards proposed above for licensed market intermediaries; and (2) the market intermediaries who are not currently covered by any proficiency regime even though they deal with retail consumers. Given the importance of harmonization, it is hoped that provinces would move forward on a consistent basis with respect to the review of licensing requirements.

Chapter 8

Open Markets

Issue

Anyone who seeks to distribute insurance products or services, or any securities products in Canada, is subject to provincial licensing and market conduct requirements. These licensing regimes contain not only proficiency standards but also determine who has access to a market on other bases, including residency and occupation (whether full-time or part-time, and whether some categories, such as employees of deposit-takers or lawyers, are eligible). Are these rules that frustrate access to markets?

Submissions to the Task Force

Financial institutions, particularly those that operate nationally, have criticized the impact of residency and occupation restrictions and market conduct rules, which differ from jurisdiction to jurisdiction. They are described as competitive barriers because, in the words of Canada Trust, they constitute a "significant compliance burden" by increasing the complexity and cost of networking by such institutions, prohibiting it entirely in certain circumstances.[189] They have implications for the development and use of new distribution methods or means. As part of the complex mix of current market conduct rules, they stand in the way of an efficient national financial services market.

Canada Trust notes that residency and occupation restrictions "were originally developed for regional markets with a single distribution style involving direct face to face contact between the intermediary and the client. Consumers are demanding convenient lower cost service and industry participants have a need to achieve those objectives through technology and automation."[190] Many of the market conduct rules present a double challenge: the rule has itself a particular impact, and the fact that the rule may be different in content or in application across a number of jurisdictions has additional impact.

189 Canada Trust, Submission to the Task Force, p. 21.

190 Ibid.

Current Situation

Canada's regulatory system historically has made an important distinction between manufacturers and distributors of financial products and services. Generally, a financial institution can distribute its own products in accordance with the legislation under which it is incorporated (either federal or provincial) and, in particular, its business powers. This is true for deposit-takers in the case of traditional "banking" products, and it is true of insurers when they are distributing their own products.[191] When an entity operates outside its pillar, or distributes a financial product or service on behalf of another entity (a mutual fund subsidiary or an arm's-length mutual fund provider, for instance), provincial distribution rules (to the extent that they exist) generally apply in law or have been complied with in practice (e.g., bank compliance with provincial securities law).

Although the distribution rules are designed to protect consumers, like all legislation and regulation, they are influenced by a mix of policy objectives, regulatory views, political factors and history. This mix can produce fundamentally different rules or different variations on the same rules from province to province.

It should be noted that distribution rules are important not only to financial service providers which operate nationally but also to financial service providers operating in one province or regionally. What might be preferable to players operating on a national level might not be so desirable on an intra-provincial or regional level, and vice versa.

Residency and occupational rules, in particular, have been significant issues in each province for some time, not only since networking and new technologies created additional pressures. They reflect, for instance, the historic tension between the centres of capital and the regions, attempts by incumbents to keep a "closed shop" and experiences with inadequate service levels.

Although most provinces appear to rely on equivalency with other provinces in the case of satisfying proficiency requirements, some provinces (e.g., British Columbia) require life insurance agents or general insurance brokers to be residents. This means that national call centres cannot operate in those provinces, and separate channels must be established or the province left unserved.

Residency requirements are well entrenched in provincial securities legislation.[192] In Saskatchewan and Quebec, a registrant who resides in the province

[191] Their employees are exempted from licensing requirements in a number of provinces under certain circumstances, although there are some rules governing the operation of call centres.

[192] Brent Sutton and Lorraine Pigeon, *Networking Financial Services in Canada*, The Conference Board of Canada, February 1996), Appendix III.

must handle all telephone calls on toll-free lines. In British Columbia, Alberta and Ontario, toll-free calls must be handled during business hours by a registrant who resides in the province, although after-hours calls may be handled by a registered non-resident. In New Brunswick and Nova Scotia, non-resident registered persons may handle telephone calls provided that the dealer also employs registered salespersons within the province. The November 1996 Investment Funds Steering Group, responding to the Stromberg Report on mutual funds, recommended changes to permit investors located in any province to use toll-free lines or other technology to place orders for securities at a centralized location.

There are a number of types of occupational restrictions at the provincial level. The first type concerns businesses that cannot be carried on together. Employees of deposit-takers, regardless of their corporate business powers, are prohibited from being licensed as insurance agents (expressly in Alberta, Saskatchewan and Ontario,[193] and by practice in some other provinces) and, in most provinces, they are barred from holding securities licences other than for mutual funds. This is arguably inconsistent with the multi-licensing which is widely allowed among provincially licensed intermediaries. The Canadian Imperial Bank of Commerce (CIBC) notes that as a result of multi-licensing, life agents may provide complete financial services while banks and trust company employees are unable to provide a full range of financial services.[194]

The second type of occupational restriction has to do with whether a registrant must be employed full-time in financial services or a particular type of product or service. These requirements have been widespread in both insurance and securities, although they are slowly changing as stepped licensing (beginners must carry on the activity on a full-time basis; higher licence levels need not) is introduced for life insurance agents and as incumbents (whether agent, broker or company, they historically have preferred a full-time requirement) lose their influence on this issue given change in work patterns and attitudes in society.[195] Although multi-licensing is inconsistent with this type of occupational restriction, it has worked in favour of registrants and is therefore not resisted.

[193] Sutton and Pigeon, op.cit., Appendix III. The Ontario Insurance Commission (now part of the Financial Services Commission of Ontario) issued its “Discussion Paper on Regulation of Insurance Distribution and Coordination of Financial Services Regulation in Ontario” in June 1998. It notes as a concern: “Occupational restrictions on individuals who can be appointed to act as insurance salespersons restrict competition. There are less restrictive measures available to assure salespersons’ compentency and to assure that consumers are not subject to the use of undue influences.” (p. 3).

[194] Canadian Imperial Bank of Commerce, Submission to the Task Force, p. 15.

[195] The Ontario Insurance Commission (now the Financial Services Commission of Ontario) Discussion Paper cited above notes: “Requirement that insurance salespersons work on a full-time basis selling insurance are unduly restrictive. There are less restrictive measures available to assure salesperson competency.” (p. 2)

Conclusion

There are questions about whose interests are served by occupational restrictions. It is sometimes argued that they have a consumer protection purpose. They are said to support prohibitions on coercion and undue influence, and to ensure greater expertise. There are market conduct rules applicable to all licensed intermediaries, however, and it is legitimate to question what the occupational restrictions add. In the case of expertise or proficiency, part-time work is a feature of virtually every sector of the economy without obvious detriment to the development and application of expertise. Given that occupational restrictions often exist to protect, or at least have the effect of protecting, already licensed incumbents from new entrants, occupational restrictions can constitute a barrier to entry and to more effective competition. In this sense, they do not necessarily have a convincing consumer protection purpose, nor are they necessarily consistent with the greater competition, and open marketplace, advocated by the Task Force. There must be a compelling reason to have an occupational restriction. The Task Force questions the purpose of the existing restrictions preventing employees of deposit-takers from being licensed as insurance agents. The Task Force suggests that the better approach is not to have an occupational prohibition, but instead to address the potential for coercive tied selling – the ostensible reason for the prohibition – through appropriate market conduct standards.

Further, the Task Force urges provincial governments to review any remaining rules mandating full-time employment as the Task Force is not convinced that these contribute to enhanced proficiency.

Residency requirements can also have an anti-competitive impact, although they may offer some assurance to consumers and regulators that the intermediary will indeed be available in the jurisdiction to deliver service or to respond to consumers and regulators. The Task Force supports increased reciprocal licensing arrangements between jurisdictions that facilitate appropriate service and lower transaction costs to the benefit of the consumer.

Appendix

Provincial Tied Selling Provisions

British Columbia

Financial Institutions Act, R.S.B.C. 1996, c. 141:

> 94. A financial institution [defined in s. 1(1) to mean a credit union, trust company or insurance company] or person acting in the transaction with the approval of a financial institution must not require as a condition of any transaction that a person who receives a product or service under the transaction must transact additional or other business with the financial institution or other person providing the product or service, except in prescribed circumstances.

Under section 2 of the Marketing of Financial Products Regulation (B.C. Reg. 333/90), tied selling is permitted only when: (a) the transaction is one under which the provision of a service or a product can be facilitated by a person maintaining an account with the financial institution; and (b) the only additional or other business required as a condition of the transaction referred to in (a) is that the person who receives the product or service must maintain an account with the financial institution for the purpose of making or receiving scheduled payments and associated costs.

Under section 3 of the Marketing of Financial Products Regulation (B.C. Reg. 333/90), all agents are required to disclose the following, in writing, to the customer or potential customer before arranging a transaction:

- the insurer(s) they represent, or the insurer with which the policy will be placed;
- that the person acts as an agent and receives a commission from the insurer for placing the policy (details concerning the amount of the commission need not be disclosed); and
- that section 94 of the Act prohibits "tied selling."

Alberta

Both a March 1995 paper issued by the Treasury Department and the August 1995 Report of the Market Conduct Subcommittee (a body of stakeholders constituted by the Alberta government to consider possible changes to the Alberta Insurance Act) stopped short of recommending that tied selling be regulated.

Saskatchewan

Proposed amendments to the Saskatchewan Insurance Act would add the following provision prohibiting conditional transactions:

> 120.1(1) No insurer, agent or adjuster, or a representative of any of them, acting in an insurance transaction shall require as a condition of any transaction that a person who receives a product or service under the transaction must transact additional or other business with the insurer, agent or adjuster, or a representative of any of them, providing the product or the service, unless allowed pursuant to the regulations or authorized by the superintendent.
>
> (2) No insurer, agent or adjuster, acting in the transaction of insurance shall participate as a party to a transaction that is conditional on the sale of another product or service.

Ontario

The May 1991 Report of the Insurance Legislation Review Project, prepared for the Ontario Insurance Commission, proposed the following in the context of networking (pp. 175, 176):

> The networking of financial products provides increased opportunities for tied selling, whereby two or more products are packaged and sold as one without the option of buying either independently …. In the context of a networking arrangement, however, tied selling might be considered objectionable whenever the sale of a product of one financial institution is made conditional upon the purchase of a product of another. On the other hand, if an arrangement simply involves an inducement to purchase the second product, it is not likely to be objectionable since the customer is left with the option of buying a single product.

These proposals did not advance beyond the stage of consultation paper.

Quebec

Currently, section 17 of the Act respecting Market Intermediaries, R.S.Q., c. I-15.1 states:

> No market intermediary in insurance business may, for the making of a contract, oblige a person to make another contract.
>
> Any person on whom a contract was imposed may cancel the contract by sending a notice by registered or certified mail within 10 days from the date on which the contract was made.
>
> The first paragraph shall not prevent a market intermediary in insurance business from offering to a person with whom he does business a set of financial products permitting a reduction of the cost.

Bill 188, an Act respecting the Distribution of Financial Products and Services, has received assent but has not been proclaimed (S.Q. 1998, c. 37). This Act applies to insurance representatives, securities representatives, claims adjusters and financial planners. Section 18 provides:

> No representative may make the making of a contract subject to the requirement that the client make an insurance contract.
>
> No representative may exert undue pressure on a client or use fraudulent tactics to induce a client to purchase a financial product or service.

Section 20 provides:

> A client may cancel an insurance contract made at the same time as another contract, within 10 days of signing it, by sending notice by registered or certified mail.
>
> Where such insurance contract is cancelled, the first contract retains its effects.

Also noteworthy is section 71:

> All firms and their executive officers are bound to act with honesty and loyalty in dealing with clients.