

2016 Financial Administrators Section Conference

Remarks of

Peter M. Klohn, Chair

Financial and Consumer Securities Commission (NB)

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The Regulatory Tsunami, Literacy and Demographics; The View From the Bleachers and the Front Lines

Good morning,

Thank you for your kind introduction.

My name is Peter Klohn. I am the independent Chair of FCNB, New Brunswick's financial and consumer services regulator. It gives me great pleasure to welcome you to the Picture Province, New Brunswick. *Il me fait un grand plaisir de vous accueillir au Nouveau-Brunswick, la province pittoresque.*

I would like to address four areas during my presentation:

- 1) A Brief Introduction to our regulator, the Financial and Consumer Services Commission (“FCNB”);**
- 2) The benefits of financial sector integration (especially for smaller jurisdictions);**
- 3) The so called “Regulatory Tsunami” (some views from the bleachers); and**
- 4) The regulatory view on the ground in New Brunswick, particularly the challenges of literacy and changing demographics.**

Before I begin, I should note that the various views I am expressing are my own and should not be interpreted as the views of the Commission, the Province of New Brunswick, the CSA or any other group or body.

1) A Brief Introduction to FCNB

With a staff of about 80 employees located in offices in Saint John and Fredericton, FCNB is responsible for the

administration and enforcement of twenty-one pieces of provincial legislation that regulate the following sectors: securities, insurance, pensions, credit unions, trust and loan companies, co-operatives, mortgage brokers and a wide range of consumer legislation.

We are an arm's length self-funded independent Crown Corporation established by the provincial government on 1 July 2013. We are funded by the regulatory fees and assessments paid by participants in the regulated sectors.

By way of background: New Brunswick has had a self-funded, arm's length independent Crown corporation for securities regulation since July 1, 2004. At that time, New Brunswick adopted modern securities legislation with a regulatory system directed by an independent agency; the New Brunswick Securities Commission. The *Department of Justice Securities Law Reform Project* came to fruition when the revamped *Securities Act* was introduced in April 2004. The legislation was proclaimed on July 1 of that same year and we haven't looked back since.

I had the privilege of being the lead consultant to the Department of Justice's *Securities Law Reform Project*.

Members of my previous law firm, Stewart McKelvey, worked with a supervising committee of government representatives to study the enormous range of issues related to securities regulation, with the goal of delivering recommendations for new securities legislation in New Brunswick.

Since 2004, the NBSC has become a complete regulatory participant with a mandate to both protect investors and foster fair and efficient capital markets, endowed with legislative tools and the financial and human resources vital for success.

Our Commission has been a committed member of the Canadian Securities Administrators (the “CSA”), the umbrella organization of Canada’s thirteen provincial and territorial securities regulators whose objective is to improve, co-ordinate and harmonize regulation of Canada’s capital markets. As such, staff in our Securities Division have, and will continue to, participate on national committees of the CSA respecting the development and drafting of securities laws and policies.

However, you may also be aware that in July 2014, the Governments of New Brunswick signed the *Memorandum of Agreement Regarding the Cooperative*

Capital Markets Regulatory System. The execution of this MoA reflects New Brunswick's strong commitment to implement a co-operative capital markets regulator. This initiative includes the governments of BC, NB, ON, PEI, SK, YU, and Canada. The goal is to better protect investors, enhance Canada's financial services sector, support efficient capital markets and strengthen the management of systemic risk.

As mentioned by your Chair in introducing me, I was recently appointed as a director of CMAIO – the Capital Markets Authority Implementation Organization which is the transition body responsible for implementing this collaborative vision. I am one of fifteen directors, all of whom were recommended by an independent nominating committee and approved by the Ministers overseeing securities regulation among the participating provinces. William Black of Halifax, the former President and CEO of Maritime Life, was previously named chair of the board in the summer of 2015.

As we are in the early days of our work, I will defer detailed comments on the role of our board and the project to our Chairman, Bill Black. But it is my hope that this new regulatory authority will lead to more effective regulation by fulfilling its potential in harmonizing

regulations and regulatory resources to avoid needless duplication. Ultimately, I believe that it is going to better serve the needs of the market, investors and stakeholders both domestically and abroad. I also believe that it will provide an innovative structure for balancing various regional interests and the diverse policy views and priorities that exist in our country.

All this to say that FCNB is a fully engaged regulator both nationally and internationally. FCNB is a member of the North American Securities Administrators Association, the voice of the U.S. state and provincial securities regulators and is also a member of COSRA, the Council of Securities Regulators of the Americas.

Now for most of you, the regulators with whom you are most likely familiar are the major ones; the OSC, BCSC, ASC and the AMF. Through the CSA, we collaborate on a daily basis with these regulators and our colleagues in other smaller jurisdictions. Naturally, we rely heavily on their resources in connection with significant national regulatory initiatives.

However, I am proud of the fact that New Brunswick has invested more heavily over the past decade in upgrading

its regulatory capacity (beginning with securities) than any other small jurisdiction in Canada.

As a result of this investment, there are some things that I believe FCNB does very well that I would like to share with you today.

For example, we developed an in-house tool to help identify online securities fraud operations. The *Scamalyzr* is a tool that identifies websites offering potentially fraudulent investment schemes. The system may flag a site as a potential risk requiring review. Despite the fact that it is not a silver bullet, it is another tool that both FCNB and fellow regulators can use to help them be more proactive in their work. FCNB is delighted that numerous NASAA members have adopted *Scamalyzr* as a securities fraud prevention tool in their respective jurisdictions.

We know our markets.

Unique among our counterparts, our mandate includes promoting capital formation activities. In addition to hosting various conferences on topics intended to encourage our fledgling capital markets, since 2010, we have published the *New Brunswick Capital Markets*

Report annually. The objectives of this report are twofold: to present a clear picture of the activity in New Brunswick's capital markets and to provide a tool to analyze capital market trends. Our goal is to provide stakeholders with a single source for in-depth analysis of our capital markets. The collection methodology used includes custom reports, published documents, interviews with stakeholders and regulatory filings. With respect to these regulatory filings, we developed an in-house monitoring system that allows us to mine this data. Notwithstanding the fact we may not have the resources of a larger CSA jurisdiction, we feel our proximity and involvement in emerging, exempt capital markets give us a unique perspective at the CSA and CMAIO table.

We were among the first regulators in Canada talking about crowdfunding, co-operated with others in implementing a start-up crowdfunding exemption and have just introduced an exemption for community economic development funds with a related tax credit program in conjunction with our Department of Finance.

In short, we understand emerging markets.

We have to be efficient.

We are also involved in the most proactive automation and technology implementation project among small regulators in Canada. Our aim is to have the most robust, modern, scalable and user friendly technology backbone to support the challenge of increasing regulatory complexity and shrinking budgets. For example, our eLicensing and forms automation initiatives will have a significant positive impact on reducing staff workloads and improving customer service. More than 100 forms – including licence applications, registration forms, records requests and many others – will be consolidated onto our website. Prior to the forms automation project, we were processing and storing forms in paper format. With thousands of licenses issued annually, the automation project will streamline processes and allow us the time to be more proactive and strategic in pursuing policy development and compliance activities.

Finally, since we are in Canada's only officially bilingual Province, we conform to our government's language of service/language of work policies. We make a unique contribution in bridging the linguistic gap which exists

among other regulators and in the translation of regulatory instruments.

2) The benefits of financial sector integration (especially for smaller jurisdictions)

I mentioned that July 1, 2013 is an important date for FCNB?

- It was on this date that consolidation of the province's financial and consumer regulatory expertise was folded into one arm's length Crown Corporation – it was the birthday of a fully integrated regulator for NB,
- We introduced an independent adjudicative Tribunal
- The separation of the roles of the Chair and Chief Executive Officer, a move that ensures FCNB embraces the highest standards of good governance (and the same model that will be used in the collaborative securities regulator). Currently, I am unique among my CSA colleagues as the only independent Chair who is not also the CEO.

FCNB now stands as New Brunswick's "one window" on financial and consumer topics, serving both industry and the public equally. It joins the Autorité des marchés financiers (AMF) in Québec and the Financial and Consumer Affairs Authority (FCAA) of Saskatchewan as one of only three integrated financial services regulatory authorities in Canada.

With the creation of the new Crown Corporation, there was a rebranding exercise which led to the adoption of a new logo. The three swooshes in our logo stylize how the three words in our tagline - regulation, education and protection - work together to achieve our vision of a confident, dynamic and informed financial and consumer marketplace for New Brunswick.

It also is a visual reflection of the power of integration. Bringing together the regulators for consumer affairs, financial institutions, mortgage brokers, insurance, pensions and securities into one organization has solidified our abilities to take advantage of operational synergies.

From a regulatory perspective, we have been working to modernize the many pieces of legislation that are now under our jurisdiction and improving the regulatory

framework across this diverse portfolio of responsibilities.

Since 2013, we have witnessed firsthand the benefits of being an integrated regulator. In addition to providing broader educational resources to the public and industry, we now realize that as an integrated regulator, the sharing of knowledge across the organization has helped our sectors learn from one another. There are practical examples of this as we consider the similarities and differences of regulating segregated funds in insurance and traditional mutual funds.

In terms of economies of scale, as an integrated regulator, we now have a number of divisions that support and enhance our regulatory functions. These groups are interconnected across the organization and are responsible for providing investigation and enforcement services; internal legal advice and legislative review services; internal and external communications, media relations and education; and research services to FCNB.

Bringing together these areas FCNB regulates was a complex process. However, it is the natural response to the fact that as financial and consumer services become

more integrated, the regulators' role of necessity becomes more integrated and the benefits of integration are magnified.

Here are a few practical examples of the benefits of integration;

- the compliance teams of our Insurance and Securities Division undertook a focused review or “sweep” of all agents/brokers or representatives that are dually licensed to sell mutual funds and insurance products such as segregated funds in New Brunswick. The purpose of the sweep was to gain a better understanding of the sales practices of dually licensed representatives and the monitoring processes that firms have in place. These results are being compiled and reported to the Executive Director of Securities and the Director of Insurance.
- Cross sector professional working groups have been established. In doing so, we are able to share information, create more efficient delivery of training and fine-tune our internal processes so we could be responsive to staff and stakeholders. In addition, in smaller markets, we tend to see common themes emerging and the same individuals

interacting with the regulator. Information sharing improves the quality and timeliness of our regulatory response.

- Finally, the technology project I referred to earlier is based on using commercial off the shelf software with the assistance of a locally based systems provider; T4G Limited of Saint John. Although a separate module is required for each regulatory area, we have enjoyed significant savings and synergies as we proceed with the project as a result of our integration. The pace and cost of implementation has been profoundly impacted by the integrated structure of our organization.

Needless to say, we believe there are economies of scale and scope available to an integrated regulator, and there is value in being able to allocate scarce regulatory resources efficiently and effectively. An integrated regulator is better equipped to tackle cross-sector issues than might be possible across a multiplicity of separate regulators.

In March 2016, a financial services review committee in Ontario called for a new, independent and integrated regulator called the Financial

Services Regulatory Authority (FSRA). We are watching these developments and those in other jurisdictions with great interest.

I believe that a highly integrated structure is the regulatory model that will eventually be followed by both small and large regulators in Canada.

I am pleased to report that New Brunswick is leading the way in exploring the benefits and testing the limits of integration.

3) The so called “Regulatory Tsunami” (some views from the bleachers)

Which brings me to this notion of the “regulatory tsunami”, this perception that the industry has been subject to an overwhelming wave of regulatory and disclosure change unlike anything we’ve ever seen. “Point of Sale” and “CRM2” are initiatives that most in this room are all too familiar with. The debate over a “best interest standard” and the CSA’s examination of mutual fund fees are raising a whole new set of issues and concerns.

Perhaps this image is a little too dramatic. How about this one which shows a surfer surviving and advancing in a Tsunami....

I don't think it would be a surprising admission that New Brunswick is not the epicenter of regulatory change. In that sense, we often find ourselves in the bleachers, more observers than active participants in the research activities which support developing a regulatory response in a perceived crisis.

However, even from the bleachers, we can see that there are potential problems with the interaction between investors and advisors which require thoughtful consideration and a balanced regulatory response. As a member of the CSA and active participant in many of its project teams, FCNB supports Point of Sale and CRM2 which were designed with investors in mind. But we want to ensure that the increased transparency about investment costs and performance and the provision of the Fund Facts are indeed helping investors make more informed investment decisions.

As regulators, we do need to "look in the mirror" and ask ourselves some tough questions. A few years ago, FAIR Canada and the Rotman School of Management's Capital

Markets Institute hosted a conference entitled “Does Disclosure Work?” Questions such as whether “disclosure received by investors assist them in making optimal choices” and “what types of regulatory responses could better address issues?” were considered.

The fact that regulators are asking themselves whether disclosure continues to work is pretty telling. In some ways, it calls into question how regulators have been operating since the 1930s.

However, in his book entitled “Wasting a Crisis – Why Securities Regulation Fails”, Professor Paul G. Mahoney of the University of Virginia School of Law uses significant historical data from the 1930 onward to advance the proposition that the most effective securities regulatory reforms are those resulting from a strengthening of existing legal rules and that responses based upon a political narrative of market failure, bad actors and lax regulation were often ineffective and counterproductive. I believe that this is an important counterpoint to the easy urge to impose new regulations.

What are my own personal views on the proverbial “regulatory tsunami”? If I may beg your indulgence, I

would like to make my own analogy to the “Tidal Bore” of New Brunswick.

One of New Brunswick’s main tributaries, the Petitcodiac River’s claim to fame is its tidal bore. It forms twice a day as the tides from the Bay of Fundy push up towards the City of Moncton. Depending on the amplitude of the phenomenon, the wave in the Petitcodiac River will vary from a few centimeters in height to as much as 75 cm. As you can see, it’s enough for a surfer with a high tolerance for mud to get down the river to his destination. In fact the North American record for the longest surf (29 km.) was set here in 2013.

I would suggest that regulation is, and should be, analogous to the Tidal Bore: a steady stream of predictable outputs which permit you to operate successfully but based on an acknowledgement that there is a lot of mud in the water as we balance competing interests of investors, industry and other stakeholders.

As regulators, how do we get to that steady and predictable “sweet spot”? For starters, as Professor Mahoney suggests, we need to stop introducing a plethora of regulations without evidence in order to be

seen as pro active in addressing the previous crisis, and be more adept at anticipating where, and how, the next crisis will unfold.

How do we manage to strike the right balance?

In my estimation, and as you can see from the highlighted section of this editorial from Investment Executive, the opinion of the investment and regulatory community generally, it is by enacting regulations that are primarily data driven and evidence based.

In her recent testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, SEC Chair Mary-Jo White remarked that they are increasingly harnessing technology to better identify risks, uncover frauds, sift through large volumes of data, inform policymaking, and streamline operations. The SEC's emphasis on technological improvements is continuing to pay dividends, improving efficiencies while allowing them to cover more ground than ever before.

Canadian regulators, notably the OSC and the BCSC, have also become increasingly data driven and are promoting evidence based policy decisions.

Although the wave of regulatory reform seems to have crested, I would expect that there will be a slow and steady release of new initiatives intended to reflect the results of this data and the tough questions that regulators are asking themselves about topics such as the effectiveness of disclosure and the reasonable expectations of investors.

These regulatory issues also have to be considered in the context of two societal trends that I would like to address.

4) The regulatory view on the ground in New Brunswick, particularly the challenges of literacy and changing demographics.

I believe that FCNB is uniquely positioned to make a significant impact in two areas of concern to all Canadians. The size of our province and its demography make us the ideal “living lab” in connection with the challenges of literacy and an aging population.

We are on the front lines of these issues.

One in five New Brunswick adults has literacy levels that are below average, putting us also below the national

average in that category. This makes our residents more vulnerable than most Canadians to being taken advantage of financially.

As a regulator, we believe that higher financial literacy is the only real long term solution to reducing fraud and protecting the interests of reputable advisors who are being held responsible for misperceptions based on a client's lack of financial understanding. This is a much more satisfying (albeit challenging) part of our work than enforcement proceedings where the likelihood of redress for an individual investor or consumer is limited.

We are trying to address this problem through various initiatives.

FCNB last year gave 108 in-person presentations to New Brunswick youth. We covered smart spending decisions, knowing the difference between wants and needs, budgeting and setting financial goals.

In addition to topical publications, robust website content, blogs, brochures, infographics, social media, and television advertising, we bring the message to our people in their communities. FCNB did a radio station summer cruiser engagement program in four New

Brunswick communities last year, hosted sessions in local coffee shops and installed community awareness kiosks throughout our Province this summer.

FCNB is a national leader in the area of literacy and we will continue to share our experience with our fellow regulators. I'd encourage you to check us out at FCNB.CA

Some of the stories we have heard of seniors being stripped of their life savings by those who prey on their vulnerability have been devastating. The simple fact is that fraud follows the money....and right now, seniors have the money.

Why do we feel especially sensitive to the issue of seniors?

Unfortunately, New Brunswick has Canada's fastest-shrinking population. Statistics Canada says that while Canada has grown by 1 million people between 2012 and 2015, New Brunswick shrunk by 3,497. According to Stats Canada, the province recently set a modern record both for the most number of deaths in a 3-month period and the least number of births.

Although efforts are underway to reverse this trend, the Province of New Brunswick faces many issues that may be harbingers of things to come in other provinces. New Brunswick may just be that proverbial “canary in a coal mine” and its changing demographics demand that it must be among the first to address the many issues associated with an aging population.

As a result, FCNB is among the leading regulators in North America dealing with these regulatory challenges.

We will continue to work with our government and stakeholders in developing an innovative legislative, regulatory and social response.

We will be bold and aggressive in taking advantage of our close relations with government and the proximity we have with our stakeholder community.

We are canvassing resources and conducting research to assist in evidence based solutions.

We have established a dedicated cross-divisional team which is helping us establish a policy direction and practical path forward.

We are collaborating on presentations on recognizing frauds and scams and the importance of proactive estate planning.

We are distributing educational materials on topics such as understanding the rights and responsibilities afforded with a Power of Attorney.

FCNB staff has worked diligently on arranging engagement sessions and meeting with seniors across the province.

FCNB has hosted a number of registrant outreach sessions with your colleagues in NB. The first step in our efforts to combat senior financial abuse is to understand the issues, challenges and barriers facing older New Brunswickers when accessing and using financial products, services and benefits.

Finally, we have taken a leadership position with the North American Securities Administrators Association in advancing their seniors' initiatives. We note with interest, the recent appointments by the OSC in a Seniors' Advisory Committee. In this, and so many other

areas, we believe that regulatory collaboration will yield the most effective, balanced results.

This demographic shift will be among the most significant regulatory challenges of the next twenty-five years and we stand ready to add our voice to the discussion and our experience to the solutions.

Conclusion -

My comments have covered a broad range of subject matter that attracts the attention of FCNB staff daily. I hope that a few of the comments strike a chord with you and give you something to think about in the context of New Brunswick's capital markets and FCNB's regulatory role.

Thank you for your time and attention. *Merci beaucoup pour votre attention.*

Please enjoy the balance of the program and the remainder of your stay in our beautiful province.