

Research Study

**Involving Consumers in Securities
Regulation**

Julia Black

June 23, 2006

**Commissioned by the
Task Force to Modernize Securities Legislation in Canada**

Julia Black

Julia Black is a Professor of Law at the London School of Economics and Political Science (LSE), and a research associate of the ESRC Center for the Analysis of Risk and Regulation at LSE. She joined the Department in 1994.

Julia gained her D.Phil at Oxford University in 1994, where she also completed her first degree in law, graduating with a First Class honours. In 2001-2 she held a British Academy / Leverhulme Senior Research Fellowship.

Her research interests are principally in the areas of regulation, public law and financial services regulation and she has published widely in these areas. She has advised a number of governmental and non-governmental bodies on issues of regulatory policy and institutional design including the UK Department for Constitutional Affairs, the Financial Services Authority, the Department for Environment, Farming and Rural Affairs, the National Audit Office, the Australian Law Reform Commission, the National Consumers Council, Demos, the Better Regulation Taskforce and the Cabinet Office.

Table of Contents

Acknowledgements.....	551
1. Executive Summary.....	552
2. Summary of Recommendations.....	557
3. Introduction.....	561
4. Consumer Involvement.....	564
i. ‘Being Involved’: Different Modes of Involvement.....	565
ii. Difficulties in Involving Consumers.....	571
iii. Involvement: The Need for Knowledge.....	573
iv. Barriers to Knowledge.....	574
a) Barriers to Consumers.....	574
b) Barriers for the Regulator.....	578
v. Summary.....	580
5. Getting a Better Understanding of Consumers.....	582
i. Getting Information: The Role of Research.....	582
ii. Generic Research.....	583
a) Research on Awareness of the Regulatory Regime.....	583
b) Research on Financial Capability.....	584
iii. Policy-Specific Research Initiatives.....	588
a) Piloting.....	589
b) Victims of Scams.....	592
c) Impact and Compliance Assessments.....	593
iv. Complaints and Contact Calls as Sources of Information.....	594
a) The Role of Complaints in Providing a Benchmark for Evaluating Compliance Monitoring.....	596
v. Linking to Investor Information and Education Initiatives.....	597
vi. Broadening the Range of Expertise Involved in Policy-Making.....	597
vii. Summary.....	598
viii. Recommendations.....	599
6. Informing and Educating Consumers.....	600
i. Information or Education?	600
ii. Key Means of Delivery.....	602
a) Web-Based Initiatives.....	602
b) Using the Media.....	603
c) Conducting Scams.....	604
d) Curriculum Development.....	605
e) Engaging in Other Fora.....	606
f) The Role of Research in Designing Information and Education Campaigns.....	607
g) Evaluating the Impact of Information and Education Activities.....	607
iii. Summary.....	609
iv. Recommendations.....	610

7.	Consultation and Participation by Consumers	611
	i. Consultation and Participation.....	611
	a) Opportunities for Open, Formal Consultation.....	611
	b) Open Meetings.....	612
	ii. Opportunities for More Active Engagement: The Role of Research.....	615
	iii. Participation.....	616
	iv. Participation: The Role of Consumer Representatives.....	616
	a) Market Regulation Services Inc.....	619
	b) OSC's Investor Advisory Committee.....	619
	c) ASIC Consumer Advisory Panel.....	621
	d) Financial Services Consumer Panel.....	621
	v. How Representative Are Consumer Representatives?.....	626
	vi. Summary.....	627
	vii. Recommendations.....	628
8.	Making a Difference? The Role of Consumer Advocates	630
	i. Key Consumer Advocates in Securities Regulation.....	630
	ii. Communicating with Regulators.....	632
	iii. How Representative Are Consumer Advocates?	634
	iv. Creating a Stronger Consumer Voice in Canadian Securities Regulation.....	635
	v. Summary.....	636
	vi. Recommendations.....	636
9.	Weighing the Consumers' Interest in Decision-Making	637
	i. Embedding Consideration of Retail Investors' Interest in Regulatory Decision-Making.....	637
	a) Formal Cost-Benefit Analyses or Regulatory Impact Assessments...	638
	b) Organizational Structures and Other Processes.....	639
	ii. Evaluating How Regulators Take Consumer Interests into Account.....	641
	iii. Summary.....	642
	iv. Recommendations.....	643
10.	Conclusion	644
	Appendix 1: Terms of Reference of the Financial Services Consumer Panel	
	Appendix 2: Terms of Reference of the Report	
	Appendix 3: Methodology, List of Interviewees and Interview Schedules	

Acknowledgements

I am extremely grateful to all those regulators, consumer advocates and consumer representatives who took time out of their busy schedules to talk to me, answer questions, and often provide me with additional sources of information or contacts. All gave very generously of their time, and I thank them. A list of those interviewed is set out in Appendix 3.

I also thank Bhupinder Khaler for her able research assistance in the early stages of this project.

1. Executive Summary

This report has been commissioned by the Task Force to Modernize Securities Regulation in Canada. The report was prompted by awareness that retail investors often do not have the same economic incentives or opportunities as institutional investors to monitor public companies and their management. They also lack effective communication channels with regulators, making it more difficult for their views and/or interests to be given proper weight in the consideration of different regulatory options.

This report examines how securities regulators in Canada and the U.K. currently involve retail investors¹ and determine their interests in designing regulation. It examines and comments upon:

- current methods of involving and determining the interests of retail investors;
- alternative methods that may have been considered and rejected; and
- the views of regulators, consumer representatives on advisory panels and consumer advocates as to the effectiveness of the current system as a method for eliciting comment and contribution on and toward prospective policies from the retail sector.²

The Canadian securities regulators focused on are the four largest Securities Commissions (in Ontario, British Columbia, Alberta and Quebec) and the three self-regulatory organizations (the Investment Dealers Association; the Mutual Fund Dealers Association and Market Regulation Services Inc.).³

Different Forms of Consumer Involvement

Effective consumer involvement:

- improves the democratic accountability of the regulator;
- builds trust and confidence;
- widens the range of information on which decisions can be based; and
- leads to a better quality of decision making.

¹ Throughout the report, ‘consumer’ and ‘retail investor’ are used interchangeably. The terms of reference of the report are set out in Appendix 2.

² A note on methodology is set out in Appendix 3.

³ At the time of writing, the IDA and RS have announced their intention to merge, but have not yet done so.

Consumer involvement in the regulatory process takes four main forms:

- information;
- education;
- consultation; and
- participation.

These form a pyramid: as the degree of active engagement increases, the number of consumers involved decreases, as do the opportunities for engagement. Thus information and education processes are open to many more consumers than consultative and participative processes, and are more widely available.

Consumers and the wider public can be involved through any of these means at any stage in the regulatory process: design, implementation, enforcement and evaluation. For the securities regulators examined here, most of the initiatives for involving consumers or the public occur with respect to policy design, but there are also examples of consumer involvement in implementation (at least via complaints data), enforcement (public interest representatives on enforcement panels), and evaluation (surveys of awareness and confidence in the regulator, and through independent consumer panels).

The different modes of involvement are interlinked. Information and education activities can equip consumers to become more actively involved, help regulators identify existing groups of retail investors, and provide entry points for more active consultation and participation strategies, which can in turn feed back into information and education activities. The different modes of involvement are also cumulative: information and education are essential pre-requisites for meaningful consultation and participation.

The key to effective consumer-regulatory involvement is knowledge on the part of both consumers and regulators. Retail investors have to know about the regulatory regime if they are to be able to be effectively involved in it. Regulators have to have knowledge about retail investors' skills, knowledge, behaviour and needs if they are to design regulations that provide them with appropriate protections.

What Securities Regulators are Doing to Involve Consumers

Canadian regulators are starting to use a wider range of strategies to get information on retail investors. These are principally:

- Research, both generic and specific; and

- Monitoring contacts and complaints and feeding this back into policy making.

Further, some are beginning to:

- leverage off information and education initiatives; and
- expand the sources of expertise involved in policy making.

In Canada, most of these strategies have developed in the last few years, and / or have become more systematized, although the pattern of use is quite varied across the regulators. Some strategies, particularly research, offer considerable scope for inter-regulatory collaboration, especially on generic issues such as financial capability and on national policy initiatives.

Information and Education

Information and education are fundamental to other, more active modes of consultation and participation. At present, securities regulators are focusing on investor information and education primarily with a view to raising financial capabilities. Information and education should also be seen as an integral part of a strategy to expand consultation and participation. Some regulators are hoping that their investor education initiatives will provide them with opportunities to identify and connect with groups who so far have been hard to hear, so that they might be brought into the consultation processes.

Consultation and Participation

Consultation processes are also beginning to change. In addition to notice and comment processes, the main methods used by Canadian, U.K. and Australian securities regulators to date are public meetings, and more focused consultations with groups of investors through focus group research. Although public meetings are common in Australia and the U.K., in securities regulation as in other areas, in Canada only one regulator has held an open meeting specifically for retail investors to air their views (the Ontario Securities Commission's Investor Town Hall). Focus group research is increasing in all three jurisdictions, however.

Active participation through investor advisory committees or consumer panels also feature in the U.K., Australian and, recently, Canadian securities regulation. Two Canadian regulators have introduced consumer representatives into their committee structures in the last year: RS and the OSC. The RS has invited an academic to serve on its main policy advisory committee to give a retail investor's perspective.

The OSC has created the OSC Investor Advisory Committee (IAC). The IAC's role and institutional structure is quite distinct from consumer panels in Australia and the U.K., however.

Regulators in other domains and jurisdictions have been experimenting with alternative forms of active participation, such as citizen's juries and other deliberative panels. These are an increasing feature of health, food, bio-technology and environmental regulation. In these processes, participants are given a course of education on the technical and policy issues in question, and in some cases on how to present formal policy proposals. The outputs of these processes are then fed into the wider policy process. These alternative forms of active participation have not been a feature of securities regulation to date in Canada, Australia or the U.K..

Further, there has been little attention paid, by any regulator, to understanding or enhancing the 'civic' capabilities of retail investors. Regulators, not only in securities, have only partial knowledge as to how best to reach and engage retail investors in the regulatory process, how best to frame questions and issues and to stimulate interest and awareness. There is even less activity on raising civic capabilities through education or training, even for specially appointed consumer representatives.

Role of Consumer Advocates

Consumer advocates can play an essential role by communicating the interests and needs of retail investors to regulators. There are many active and committed individual consumer advocates in Canada, and a few advocacy groups. However, on the whole the larger, established national consumer advocacy bodies have not been active in securities regulation. This contrasts with the position in Australia, the U.K. and the EU. Whilst there are many committed and active individuals, there is no real, coherent, national, well-resourced consumer voice representing the interests of all Canadian retail investors in securities regulation.

Embedding Consumer Interest in Regulatory Decision Making

A key issue is the extent to which awareness and consideration of consumer interests is embedded in the regulators' decision-making process. The pattern here is highly variable. The Canadian Securities Commissions undertake some type of cost benefit or impact analyses of their proposed regulation or policy changes. Some regulators have formal organizational structures and processes to identify emerging risks, for example, or co-ordinate across policy and enforcement divisions, or to utilize

complaints data. Often, the processes are more informal. Processes range from the quite systematized risk mapping conducted by the FSA to more informal processes, which focus mainly on linking enforcement and complaints data with policy-making divisions.

Recommendations

The research findings suggest that Canadian regulators are recognizing that engagement with retail investors can be valuable, and are starting to seek active ways of achieving it. Some of these initiatives are in their infancy, and many regulators are unsure as to which strategies are likely to be the most effective.

There is no ‘silver bullet’, no single strategy that will solve all the problems and meet all the goals. This does not mean that nothing can be done. Rather any strategy for engaging consumers has itself to be multi-faceted and vary with the purpose for which involvement is sought.

The first step is to break down involvement into its four main modes: information, education, consultation and participation. Enhancing involvement means making enhancements in one or more of the different modes. The next stage is recognizing that mode of involvement serves a different purpose and has different advantages and drawbacks. Choosing which to use in any particular policy initiative requires recognizing their different purposes and potentials.

Two Key Principles of Successful Involvement

However, for all the different modes of involvement there are two key elements of success:

- being clear as to the purpose of involving consumers and the role they will play; and
- working with consumers them to help build their capacity to be effective participants in the regulatory process.

Specific Recommendations

More specifically, there are 30 recommendations coming from the research. These are aimed primarily at Canadian securities regulators, and where appropriate, consumer representatives and consumer advocates. They are organized in accordance with the structure of the report. Given the variability in practices across regulators, some recommendations are more relevant for some regulators than others.

2. Summary of Recommendations

There are 30 recommendations stemming from the research. These are aimed primarily at Canadian securities regulators, and where relevant, consumer representatives and consumer advocates. Because of the variability in practices, some are more relevant for some regulators than others. They are organized in accordance with the structure of the report.

Getting Information on Consumers

Recommendation #1.1: Current initiatives to develop a national Investor Index that gathers data on retail investors' skills, needs, behaviour and awareness of the regulatory regime should be implemented as a matter of priority. The database should enable analysis across different demographic groups. The research should be repeated on a 3-5 year basis.

Recommendation #1.2: Integrate the findings of research into all communication, education and policy initiatives concerning retail investors.

Recommendation #1.3: Expand the use of consumer research with respect to specific policy initiatives where these have a significant impact on retail investors, including research into the dynamics of the advisory / sales process, experiences of the complaint processes and consumer understanding of disclosures.

Recommendation #1.4: Develop consumer research methodologies to evaluate the impact of existing and new policy initiatives on retail investors. Where policies are harmonized across jurisdictions, the research should be done on a collaborative and / or national basis as far as possible.

Recommendation #1.5: Develop consumer research strategies as part of the compliance process, e.g. through routine mystery shopping exercises.

Recommendation #1.6: Use information from complaints databases, including OBSI's complaints data, systematically to inform policy initiatives.

Recommendation #1.7: Publish the findings of all research initiatives in a systematic, accessible and timely manner.

Information and Education

Recommendation #2.1: Establish and expand links with strategic partners in developing and delivering information and education to retail investors, including non-financial media and websites. Use the findings of financial capability research to identify the most vulnerable groups.

Recommendation #2.2: Differentiate target groups and ensure the content, presentation and mode of delivery of information and education is appropriate for the relevant group.

Recommendation #2.3: Develop performance measures to assess the impact of information and education initiatives.

Recommendation #2.4: Ensure information and education initiatives are seen within the regulatory organization as an integral part of a strategy of involving consumers.

Recommendation #2.5: Use the strategic partnerships developed and the information gained through information and education initiatives to enhance consumer consultation and participation.

Consultation and Participation

Recommendation #3.1: Use plain language in all consultation papers and make their relevance for retail investors clear from the outset. Allow equal access to timely and relevant information that is easily understandable.

Recommendation #3.2: Systematically monitor the responses to consultations received from individuals and retail investors and give specific feedback on their responses.

Recommendation #3.3: Publish the results of all consultation processes including responses received to consultation papers, unless the respondent specifically indicates it does not want the response published.

Recommendation #3.4: Expand the range of consultative methods used to ensure involvement of as wide a range of groups and individuals as possible.

Recommendation #3.5: Engage in more direct participatory methods including multi-stakeholder workshops, in which representatives of industry and retail investors can discuss policy options.

Recommendation #3.6: Expand the role of consumer representatives in all securities regulators, including the CSA, through the establishment of investor advisory committees, consumer panels or similar bodies.

Recommendation #3.7: Ensure all investor advisory committees / consumer panels have a clear remit, are adequately remunerated, have an independent budget to allow them to commission research; have timely access to all relevant information, including research conducted by the regulator or others, and are given the necessary training to enable them to be effective.

Recommendation #3.8: Consumer representatives should publish a summary of their activities on an annual basis, including the criteria by which their priorities are established.

Recommendation #3.9: Consumer representatives should develop methods of collaboration with representatives in other securities regulators, nationally and internationally, wherever possible.

Recommendation #3.10: Regulators should develop programs to enhance the civic capacity of retail investors and consumer representatives to enable them to be effective participants in the regulatory process.

Recommendation #3.11: Regulators and consumer representatives should develop methods for assessing the impact and effectiveness of different consultation and participation methods, including the activities of investor advisory committees or consumer panels.

Consumer Advocates

Recommendation #4.1: Regulators and others need to work together to develop a credible, national, well resourced and coherent voice for consumers in Canadian securities regulation.

Recommendation #4.2: A greater degree of trust needs to be established between consumer advocates and regulators in situations where it is currently lacking.

Recommendation #4.3: Regulators should facilitate cross-jurisdictional engagement with consumer advocates on common issues and policy initiatives.

Recommendation #4.4: Consumer advocates and regulators should engage in collaborative research on consumers' experiences of dealing with the regulated industry and with the regulatory bodies, including complaints processes.

Embedding Consumer Interests in Decision-Making

Recommendation #5.1: Develop and regularly review systematic processes for assessing, prioritizing and addressing the risks and benefits to consumers of proposed policy initiatives.

Recommendation #5.2: Develop and regularly review systematic methods for assessing the impact of existing policies on consumer detriment.

Recommendation #5.3: Establish consumer director / leader who is responsible for coordinating, assessing and reporting on how effectively consumer interests are taken into account in decision making.

3. Introduction

Aims and Scope of Project

This report has been commissioned by the Taskforce to Modernize Securities Regulation in Canada. The report was prompted by awareness that retail investors often do not have effective communication channels with regulators making it more difficult for their views and/or interests to be given proper weight in the consideration of different regulatory options.

The Taskforce to Modernize Securities Regulation in Canada commissioned this report to explore how securities regulators, principally in Canada and the U.K., currently determine the interests of retail investors in designing regulation, and the different approaches available to regulators to engage in a more effective and meaningful dialogue with retail investors including the role of consumer advocacy groups. The report therefore focuses on modes of consumer involvement in securities regulation, in those countries, with some comparisons with Australia where relevant.⁴

Consumer involvement is an important issue. Consumers are increasingly being expected by governments to take responsibility for their own financial well-being, and they face a complex financial market place. Moreover, the increased in life expectancy and changing nature of pension provision mean that many more are facing an uncertain financial future on retirement. However the majority lack the skills and knowledge to make financial decisions and to navigate this marketplace.

Moreover, retail investors do not have the channels of communication with regulators that are open to the industry and institutional investors. So although the securities regulators have a mandate to protect consumers, the consumer ‘voice’ in the regulatory processes is often muted.

Involving consumers in the design and implementation of the regulatory regime is important not only for the regime’s democratic accountability, but for its effectiveness. It allows regulators to access different sources of information, perspectives and solutions. It can improve the quality of decision making and build trust in the regulator.

⁴ Throughout the report, ‘consumer’ and ‘retail investor’ are used interchangeably. The terms of reference of the report are set out in Appendix 2.

This report examines how securities regulators in Canada and the U.K. currently involve retail investors and determine their interests in designing regulation. It examines and comments upon:

- current methods of involving and determining the interests of retail investors;
- alternative methods that may have been considered and rejected; and
- the views of regulators, consumer representatives on advisory panels and consumer advocates as to the effectiveness of the current system as a method for eliciting comment and contribution on and toward prospective policies from the retail sector.

The research focuses on the following regulators and associated consumer representative bodies where these exist:

Canada

- Ontario Securities Commission (OSC)
- Alberta Securities Commission (ASC)
- Autorité des Marchés Financiers, Quebec (AMF)
- British Columbia Securities Commission (BCSC)
- Investment Dealers Association (IDA)
- Market Regulation Services Inc (RS)
- Mutual Fund Dealers Association (MFDA)
- Relevant consumer advocates

U.K.

- Financial Services Authority (FSA)
- FSA Consumer Panel (FSCP)
- Relevant consumer advocates

Comparisons are also drawn with the Australian securities regulator, the Australian Securities and Investments Commission (ASIC) and its Consumer Advisory Panel where relevant.

What the Report Does Not Cover

There are therefore a number of issues that are significant for retail investors but fall outside this report. In particular, the report does not assess adequacy of securities regulation in protecting investors, in Canada or elsewhere. Hence it does not look at the substance of the regulatory provisions. Nor does it explore or comment on the adequacy of the current systems for dealing with complaints and providing redress. Nor does it consider the question of whether there should be a single, federal securities regulator in Canada. All of these issues are clearly of fundamental importance to retail investors but they are not within the scope of this report.

Structure of the Report

The report focuses on the following issues in turn:

- What consumer involvement in regulation consists of, the difficulties of involving consumers, and the important interactions between knowledge and the different forms of consumer involvement;
- How regulators are gaining a better understanding of consumers;
- Involvement with consumers through information and education activities;
- Involvement with consumers through active consultation and participation strategies, including consumer panels and investor advisory groups;
- The role of consumer advocates in the regulatory process;
- Weighing the consumer interest in the decision process; and
- Conclusions and next steps.

4. Consumer Involvement

As the balance between individual and government responsibility has been shifting, in Canada as elsewhere, consumers are increasingly being required to take responsibility for their own financial well-being. However they face a financial marketplace that is complex and fast changing.⁵ It is one that repeated research has shown that consumers find hard to navigate, and where regulatory intervention has long been justified on economic grounds.⁶

All the Canadian securities regulators considered in this report have a mandate to protect investors. But as most are recognizing, without knowing what protections investors need, it is impossible to fulfil that mandate effectively. Knowing what investors need means involving them, and being involved with them. Given that few consumers actively involve themselves in securities regulation, regulators need to take proactive steps to engage with them. As many regulators are recognizing, this means doing far more than following the traditional practices of basic information provision and paper-based notice and comment processes.

Canadian securities regulators have nevertheless been criticised for failing to sufficiently engage with retail investors in the past,⁷ and the issue is beginning to figure more highly on the political agenda. For example, in 2005 the Standing Senate Committee on Banking, Trade and Commerce had extensive hearings on consumer issues arising in the financial services sector. Each committee hearing was broadcast on CPAC⁸ and over the internet. The aim of the study was to determine the effectiveness of regulatory oversight of the financial industry and the impact it has, if any, on benefiting the consumer interest and the public interest.⁹

Involving retail investors in securities regulation is not easy, however. This section provides a general framework for the subsequent sections by exploring in general terms:

- the different ways consumers can be involved in the regulatory process;

⁵ See e.g. PRI, FCAC & SEDI, *Why Financial Capability Matters* (Ottawa: April 2006).

⁶ There are numerous discussions of market failures in financial services: for a good summary see C. Goodhart et al, *Financial Regulation: What, Why and Where Now?* (London: 1998).

⁷ See e.g. Consumer Council of Canada, *Annual Report of the Directors, 2003-4*, p.9.

⁸ The Canadian Public Affairs Channel, a privately owned, not for profit bilingual television service, which specializes in public affairs programming.

⁹ The Terms of Reference, issued on 23rd November 2004. Hearings were conducted during the course of 2005, and the committee is due to report in 2006.

- the difficulties in involving consumers in practice;
- the need for knowledge for involvement to be successful; and
- the links between knowledge and the different modes of involvement.

i. ‘Being Involved’: Different Modes of Involvement

For consumers, ‘being involved’ in securities regulation can mean different things:

- buying a regulated product / receiving advice from a regulated person;
- receiving information or education from regulators, either directly or indirectly;
- contacting regulators call centres / websites;
- using complaints resolution bodies to gain redress from regulated persons;
- being consulted on the rules, policies and practices of the regulator;
- active participation in the rule making and implementation of the regulatory system; and
- being represented by organizations that are actively commenting / participating.

Thus, at its broadest, consumer involvement encompasses all interactions the consumer has with the regulatory system. Most of these interactions are indirect, and indeed consumers are usually unaware of them.

When a consumer seeks advice or buys a product from or through a regulated person, the consumer interacts with the regulatory system in that the relationship he or she enters into is governed by its rules. Those rules give the consumers rights in certain circumstances, but the consumer is still expected to take responsibility for his or her investment decisions – the principle of *caveat emptor* is modified to varying degrees in different regulatory regimes, but rarely excluded altogether.

The consumer, however, is usually only vaguely aware of the existence of these rules, or indeed of the regulator who formed them, let alone their specific content. Successive surveys by financial regulators in Canada and elsewhere show low rates of unprompted awareness of the regulator amongst the public as a whole, and prompted awareness is often only slightly higher. Retail investors (as opposed to members of the public generally) are more likely to know about the regulator, but a significant proportion still do not.

A recent survey by the U.K. Financial Services Authority (FSA), for example, found that 43% of people who had bought an FSA-regulated product were not aware that a financial regulator existed.¹⁰

The interface between the regulator and the consumer is much more obvious to the consumer when he or she wants to seek redress. Indeed, regulators are often perceived by consumers, usually incorrectly, as being the last port of call in a complaints process.¹¹ Although engaging with regulated products and services, and seeking redress, are the most common forms of interaction consumers have with a regulatory regime, they are not typically considered to be forms of involvement in policy making. The nature of the complaints being made may inform the policy process, but of itself making a complaint or using a dispute resolution mechanism such as an Ombudsman does not constitute participation in the regulatory process in the sense used here.

Rather, consumer involvement in policy processes is usually seen as being a continuum from information and education, to consultation, to participation. *Information-giving* is often a one-way exercise: information is given by regulators on the regulatory system. This information may either simply be made available through annual reports, the ‘about us’ sections of regulators’ websites and through other such means, or the regulator may engage in more active campaigns to raise awareness and understanding of its role. In financial services, many regulators also give generic information and advice on financial products and services, and on investment decision making.

Education involves building people’s capacities: their skills, competence, knowledge and understanding. Financial education and financial capability strategies have become increasingly important for financial regulators in Canada, Australia and the U.K., and many are developing extensive strategies to raise financial capability amongst the general public.

Information and education are essential prerequisites for the more direct forms of engagement in policy making, namely consultation and participation. Without the requisite knowledge both about the regulatory system but also about the financial marketplace that it is regulating, people cannot contribute effectively to the regulatory process. Thus although financial education and information campaigns are sometimes treated as separate from policy making, both conceptually and operationally, the two are fundamentally linked.

¹⁰ FSA, *Awareness of the FSA*, CRPR 39 (London, 2005).

¹¹ National Consumers Council, *Involving Consumers: Everyone Benefits* (London, 2001), available at <http://www.ncc.org.U.K./involvingconsumers/index.htm#invcon>.

Consultation is a dialogue between the public and the regulator, and provides a means by which the public can give their responses to policy proposals being made by regulators. For it to work, the regulator has to make available information on what it is doing, and why. Consultation practices are highly variable across regulators and across countries and include:¹²

- the publication of notice and comment or consultation papers
- questionnaires and opinion surveys
- public meetings
- toll-free telephone lines
- targeted briefings
- web-based questionnaires / comment facilities
- focus groups
- multi-stakeholder negotiations
- web-based reference groups.

Participation is a more direct and active form of involvement – it is about consumers or consumer organizations being directly engaged with the policy making processes: in defining the issues, setting the agenda, and shaping the policy debate, although the final decision rests with government. Participation requires even higher levels of knowledge, and therefore requires the development of tools to facilitate learning, debate and the drafting of concrete proposals on the part of those involved. Relatively few countries have begun to explore different ways of securing participation in this way. Methods include:

- participation by consumer representatives in consumer panels, committees or other forums that advise or comment on regulators work;
- consumer or multi-stakeholder workshops / negotiations;
- citizen's juries;
- consensus conferences; and
- web-based 'reference groups'.

The degree to which regulators support these initiatives through improving the 'civic capacity' of consumers varies considerably. By 'civic capacity' is meant the knowledge and ability not just to

¹² See OECD, *Citizens as Partners: Information, Consultation and Public Participation in Policy Making* (Paris, 2001).

understand the technical and policy issues involved, but to formulate and present arguments and policy proposals.¹³

Citizen's juries, consensus conferences or citizen's panels can be quite intensive exercises in which consumers receive education on the technical and policy issues involved in specific questions or proposals, and are then given the time and opportunity to formulate and deliberate policy options over the course of several sessions, which can last any number of days. Citizen's juries are an increasing feature of bio-technology, health and environmental regulation,¹⁴ but have not yet reached financial regulation. Deliberative research methods such as focus groups also allow more active consultation and participation, and these have been increasingly deployed in financial regulation.

Web-based reference groups can be another means of reaching a relatively wide range of people. In the U.K., the National Health Service Information Authority developed a virtual public reference group whose purpose it is to make it easier for the Authority to consult and involve consumers in its work. It had about 500 individual consumers who agreed to provide a ready-made pool of people to help in all stages of projects, from planning to evaluation by participating in consultations, focus groups, critiquing external communications, sitting on project boards or advisory groups, participating in seminars and conferences, training and evaluation.¹⁵

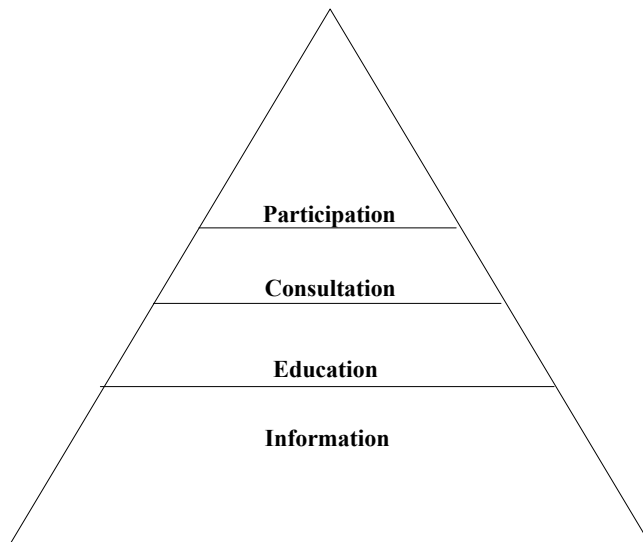
As the different forms of involvement between regulator and consumer become more active and focused, the number of retail investors involved decreases. The four principal modes of active consumer-regulatory involvement thus form a pyramid. At the bottom are the most common initiatives used by regulators, which are also those in that are open, at least in principle, to most of the public, including consumers, and which are the least intense forms of involvement. As one moves up the pyramid the number of initiatives decreases, the number of the public involved decreases and the intensity increases, through education, consultation, to participative modes at the very top.

¹³ On the need for such training see OECD, *Citizens as Partners: Information, Consultation and Participation* (Paris, October 2001); NCC, *Involving Consumers*.

¹⁴ See for example the recent initiative by the Environment Agency and Demos to hold a citizen's jury on the use of nanotechnology in land remediation on London's Olympic sites. Citizen's juries have also been used by the U.K. Food Standards Agency to formulate policies on GM foods. Details on citizens' juries can be found from the Jefferson Centre, which is a key advocate for this process in the US: <http://www.jefferson-center.org>.

¹⁵ See NCC, *Involving Consumers*.

Figure 1: Modes of Involvement



Clearly the lines between these different modes of involvement are blurred: information shades into education into consultation into participation. Exactly where any one initiative falls on the continuum is not that important – the issue is the extent to which these and other methods can allow regulators to gain an understanding of peoples’ views and needs, and for them to be meaningfully engaged in the regulatory process.

It is important to stress that the modes of involvement are also cumulative, for both consumers and regulators. Consumers cannot be meaningfully consulted or participate unless they have information and unless they are educated and have an awareness of the issues involved and the options available, including the limits on the regulator’s powers. Regulators cannot know how best to protect investors unless they have information and are educated as to the nature of consumers’ skills, knowledge, behaviour and needs, and can shape their strategies for ensuring meaningful consultation and participation accordingly.

At what stages of the regulatory process can consumers be involved?

Although emphasis is most often placed on involvement in regulatory policy making, involvement can potentially occur at all stages in the regulatory process: policy and rule making, implementation, enforcement and evaluation, as illustrated in Figure 2.

Consumers and the public more generally can be involved in the implementation of the rules at a very minimum by being aware of their rights and responsibilities under the regulatory system and requiring firms to treat them appropriately. Complaints and redress systems can play an important role in this respect – consumers can provide valuable information through the regulators’ contact centres and complaints bodies, which regulators could use to shape their policies and monitoring and enforcement activities.

Investors or the public can be involved in enforcement through participation on enforcement panels, or more directly through restorative justice or victim-offender conferences mediated by the regulator.

Whilst the securities regulators considered here have not engaged in restorative justice exercises, they frequently do have public interest members (usually qualified lawyers) on their enforcement panels.

Finally, the public can be involved in the evaluation of the regulatory regime through if their opinions are included in evaluation assessments, for example. Consumers can be more actively, if indirectly, involved in independent evaluations of the regulator via a representative body, such as a consumer panel or other civil society organization. Consumer panels and advisory groups are discussed further in Section 7.

Figure 2: Examples of public involvement in different stages of the policy process

Stage in the policy process	Information / education	Consultation	Active Participation
Design / rule formation	<ul style="list-style-type: none"> • Publication of policy documents, proposed legislative / rule changes 	<ul style="list-style-type: none"> • Invitations to comment • Surveys • Focus groups / workshops 	<ul style="list-style-type: none"> • Citizen’s juries • Representative panels / advisory groups • Consensus conferences
Implementation	<ul style="list-style-type: none"> • Information on compliance and non-compliance, e.g. scams • Publication of guidance / waivers 	<ul style="list-style-type: none"> • Facilitating notification by the public of complaints, non-compliance 	<ul style="list-style-type: none"> • Engaging community and other groups in disseminating information on the rules and monitoring compliance • Whistleblowers protection
Enforcement	<ul style="list-style-type: none"> • Publication of enforcement activities, including hearings and settlements 	<ul style="list-style-type: none"> • Facilitating notification by the public of complaints, non-compliance 	<ul style="list-style-type: none"> • Public interest members involved in tribunals / enforcement panels • Restorative justice conferences
Evaluation	<ul style="list-style-type: none"> • Public notice of evaluation exercises and their outcomes 	<ul style="list-style-type: none"> • Including public opinion of the regulator in evaluation exercises, e.g. through surveys; focus group discussions 	<ul style="list-style-type: none"> • Evaluation of the regulator by independent organizations, e.g. consumer panels or civil society organizations

ii. Difficulties in Involving Consumers

Involving consumers is a difficult task, however, at any level of the pyramid and at any point in the regulatory process. Consumer awareness of the regulatory system is low in both Canada and the U.K.¹⁶ Most consumers get their information about financial products from firms’ marketing literature; very few seek generic advice such as that provided by many of the regulators or are aware that it is available.¹⁷

¹⁶ See e.g. OSC, *Stakeholder Satisfaction Survey: Wave 3, Final Report* (Toronto, 2004); FSA, *Awareness of the FSA*, CRPR 39 (London, 2005).

¹⁷ FSA, *Levels of Financial Capability in the U.K.: Results of a Baseline Survey* (London, 2006).

There is also little awareness of what regulators actually do. Research by the National Consumers Council in the U.K. found that most consumers see regulators as the last port of call for customers with complaints, rather than decision makers for their sector.¹⁸ Experience of the OSC's Investor Town Hall tends to support that finding.

Public consultation through notice and comment processes offers the potential for involvement, but on its own does not provide a real opportunity. Commenting on proposed changes to securities laws requires a level of interest, knowledge and time that most consumers simply do not have. Although figures are not kept, the securities regulators considered here reported anecdotally that there are very low levels of consumer responses to consultations, usually in single figures. This experience is common across many other regulators in different domains.

Open meetings may provide a good opportunity for consumers to ventilate their grievances, but they are rarely the place for in-depth engagement. The result can be frustrating for both regulator and those consumers that attend, as discussed in Section 7, below.

Further, many consumers are sceptical about consultation processes. There is a common perception amongst the public that regulators and other public bodies only consult the public because they have to, rather than because they want to. Consultations are often seen as 'window dressing' for decisions that are made behind closed doors. Further, many of those that do attempt to get involved complain of being made to feel inferior at meetings and not taken seriously.¹⁹

Direct participation through membership of a regulatory advisory committee or consumer panel is potentially more fruitful form of involvement, as discussed further below, but the majority of consumers are effectively ruled out from these forums by their lack of knowledge, interest and / or time.

Consumer organizations can theoretically be a solution to the problems of lack of skill or time for individual consumers. But consumer organizations face problems of collective action: whilst it is rational for each individual to free ride off the work of others, when everyone chooses to do nothing, nothing gets done. Canada lacks a powerful, national consumer voice that speaks for all retail investors in securities regulation. There are national consumer organizations, but securities regulation is either outside their

¹⁸ NCC, *Putting Up with Second Best: Summary of Research into Consumer Attitudes to Involvement and Representation* (London, 2002).

¹⁹ NCC, *Putting Up with Second Best: Summary of Research into Consumer Attitudes to Involvement and Representation* (London, 2002).

remit, as is the case with the FCAC, or they have not been particularly active in securities-related issues in recent years, as is the case for the Consumers Council. As discussed in Section 8, CARP is the closest Canada gets to a national consumer voice in this area.

iii. Involvement: The Need for Knowledge

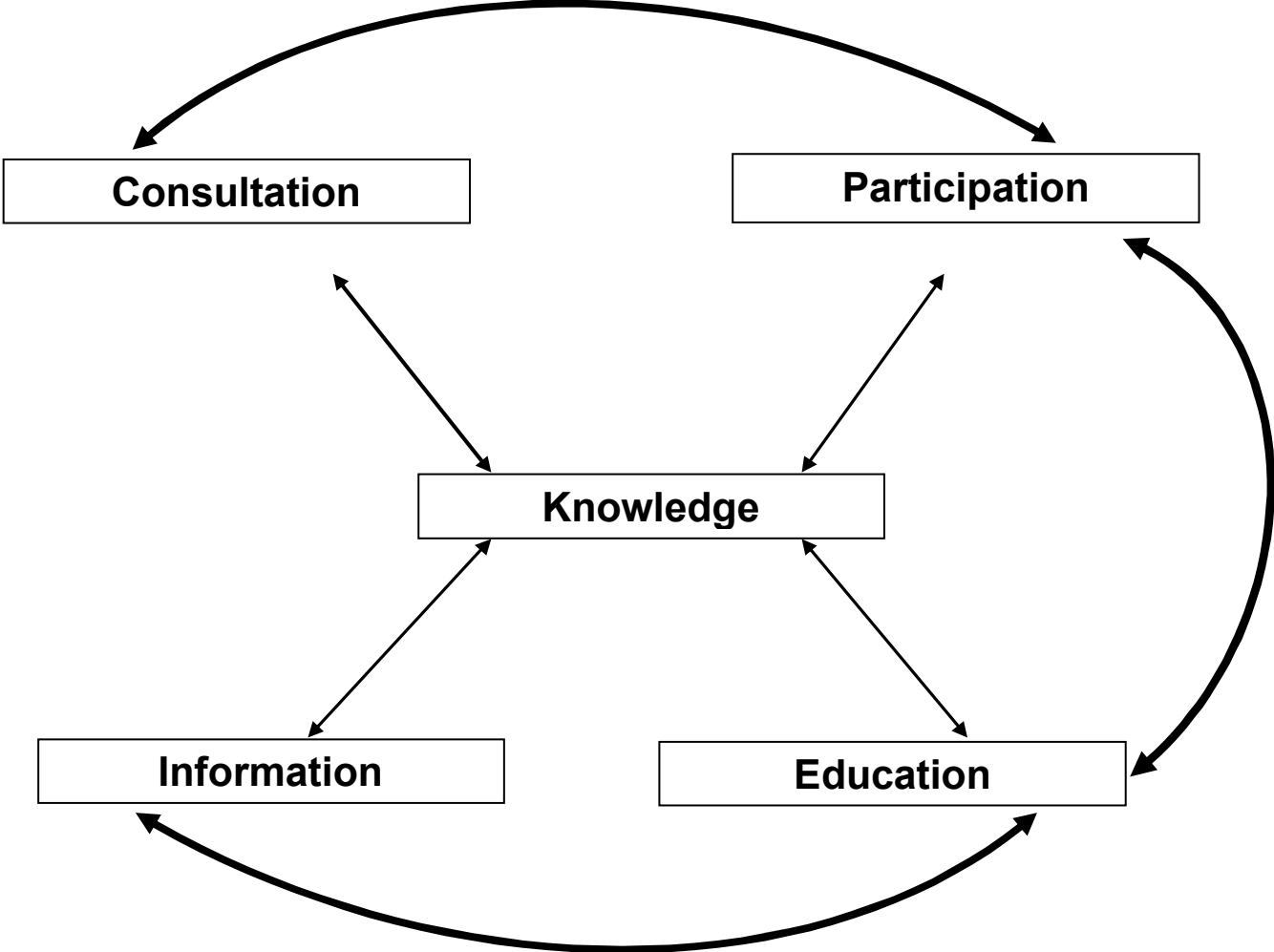
Each mode of involvement, by consumer or regulator, requires knowledge. Consumers need to know about financial products in general and their products in particular, the type of relationships they can expect from advisors, and the rights and responsibilities they have under the regulatory regime.

Consumers have to be able to assess whether they have grounds for a complaint, how to seek redress, and to evaluate whether their application for redress has been wrongly rejected or if the redress offered is adequate. Consumers need knowledge to understand the meaning and implications of current securities rules and proposed changes to them if they are to participate in the shaping of those rules.

Regulators also need knowledge. In order to give consumers information about the regulatory system that is accessible and relevant, regulators need to know what information the consumer needs, and where he or she is likely to look for it. If regulators are to help consumers make the right investment decisions, regulators need to know the nature of consumers' investment skills, knowledge and behaviour. If regulators are to enable consumers to participate in shaping the rules, they need to know what types of opportunities are likely to be most effective. Fundamentally, if regulators are to write rules that are meant to protect investors, they need to know what protections consumers want and / or need.

Knowledge, information, education, consultation and participation are thus inextricably interlinked, as illustrated in Figure 3. Knowledge informs regulatory strategies on information, education, consultation and participation; participation and consultation enhance the knowledge of both regulator and consumer; information and education strategies can introduce regulators to different types of consumers and provide them with entry points for more active consultative and participatory strategies.

Figure 3: Relationships between knowledge and modes of involvement



iv. Barriers to Knowledge

Although knowledge is critical for consumers and regulators, significant barriers to acquiring and using knowledge exist for both.

a) Barriers for Consumers

For consumers, these barriers include:

- Low levels of financial literacy;
- Variety and complexity of financial products;
- The nature of financial products and services; and
- The difficulties of making decisions in the face of uncertainty.

Low Levels of Financial Literacy

Research from the Canadian Adult Literacy and Life Skills survey, which tested 23,000 Canadians, found that 42% of Canadians do not have the basic literacy and life skills to cope with the demands of the knowledge society and economy. One out of every 7 individuals between the ages of 16-65 (over 3 million adults) scored at the lowest performance level.²⁰

The situation in the U.K. is no better. Over half of people aged between 16-65 (up to 16 million adults) have reading levels expected of children leaving primary school at age 11. Levels of numeracy skills are similar.²¹

Low levels of literacy and numeracy pose a serious challenge for both consumers and regulators. Securities regulation is heavily dependent on strategies of disclosure. The underlying principle is that if investors have information, they will make the appropriate investment decision. However, the low levels of general and financial literacy show that information has to be put in extremely straightforward and simple terms if consumers are to be able to understand it.

²⁰ Figures cited in the PRI, FCAC and SEDI report, *Why Financial Capability Matters: Synthesis Report on Canadians and their Money* (Ottawa, April 2006).

²¹ See Public Accounts Committee, *Skills for Life: Improving Adult Literacy and Numeracy*, 21st Report, HC 2005-6 available at <http://www.publications.parliament.U.K./pa/cm200506/cmselect/cmpubacc/792/79202.htm>. More figures are available from the Literacy Trust: www.literacytrust.org.U.K.

Variety and Complexity of Financial Products

Financial products, even those which are sold to retail investors, are often complex. Moreover, there is a huge variety of products, many of which are in fact quite similar in their underlying nature, but which financial product providers attempt to differentiate from their competitors by slight changes to their nature. There are over 2,000 mutual funds on the market in Canada, for example; over 8,500 mortgages available in the U.K.. Financial products are to this extent like any other product in a competitive market – nearly every washing powder is the same, but manufacturers attempt to create real or apparent differences between them in order to gain market share.²²

Product providers also create products that combine different forms of product in new ways, ways which are usually obscure to investors. Segregated funds, for example, are essentially a mutual fund in an insurance wrapper – thus creating confusion both for regulators (who regulates it, the insurance regulator or the mutual fund regulator), and for the investor. Principal protected notes in fact expose investors to the investment strategies of the hedge funds in which their money becomes invested; exposure which they are protected from should they try to invest in a hedge fund directly

The Nature of Financial Products and Services

It could be argued, however, that complexity is not of itself a reason to have extensive consumer protection, or indeed to give investors any particular protection that is distinct from that offered to consumers of electrical goods, for example. Computers are complicated pieces of equipment, and most consumers have only a rudimentary knowledge of how they operate. But as long as they work and provide the functionality the consumer needs, he or she does not want to know how they work, nor do they need to know.

Where the analogy between computers and financial products breaks down is in the ability of the consumer to know when he or she has made a bad buy. This knowledge means the consumer may be able to seek redress, at least if the product is still under warranty, or at least to avoid buying that product again. Computers are thus, in economic terms, experience goods. Consumers can learn the quality of a computer from their experiences of using it.

²² For discussion see C. Scott and J. Black, *Cranston's Consumers and the Law* (London, 2000).

In contrast, financial products and services, particularly those which are sold to retail investors, are credence goods. In other words, a consumer does not have the skill and expertise to assess their quality. Financial advice, for example, is akin to legal advice or medical advice: unless the consumer has a level of understanding and knowledge that is the same as the advisor's, he or she will not be able to assess its quality. Those who advise on financial products do not have to have nearly the same level of qualifications as those who advise on medical or legal matters, however.

There is evidence that increased experience in buying a range of financial products does improve a person's financial capability.²³ However, there is a significant step between correctly identifying that a particular type of investment product is the most appropriate one to buy, and identifying which particular product of that type is the best quality. Moreover, many of the products are infrequent purchases, such as pensions or life insurance contracts, giving little opportunity for experience to inform a person's purchasing decisions.

Further, investment products are incomplete contracts. Their value, in other words, is determined after the contract has been agreed, and is dependent on the activities and skills of others, be they brokers, fund managers, company directors. This is so even in circumstances where no fiduciary relationship arises, but is enhanced in circumstances where it does. Moreover, many of the products are long term – five, ten, twenty or more years. Even if a consumer could assess the quality of his or her pension on retirement, it's too late to take it back.

These characteristics of financial products mean that adverse selection is very likely. In other words, because consumers cannot assess quality, they differentiate products on their price. Assuming they are rational, they will opt for the lowest, or perhaps second or third lowest price, regardless of quality. High quality products, which cost more, are thus driven out of the market by lower quality products, resulting in an overall deterioration of product quality.

From a regulatory point of view, the same can happen to levels of compliance, creating a similar effect. Firms that fully comply with the rules incur higher compliance costs than those that have far lower levels of compliance. These costs are passed on to the consumer. However, because consumers cannot differentiate between products, or quality of advice, they will go for the lower cost product. This can create a 'market in non-compliance' in which compliant firms are effectively driven to non-compliance

²³ FSA, *Levels of Financial Capability in the U.K.: Results of a Baseline Survey* (London, 2006).

by the non-compliance of others, absent rigorous and effective enforcement action.

Making Decisions in the Face of Uncertainty

Financial decisions are about risk and uncertainty. Repeated studies on how people understand and respond to risk demonstrates that their behaviour departs significantly from the rational actor model on which many assumptions about consumer behaviour are based.²⁴ Moreover, financial decision-making is often emotive and so in this sense irrational.²⁵

Research has also shown that people have a poor understanding of risk in general, and of financial products in particular. The recent U.K. financial capability research found that there was often a mismatch between people's stated risk profile and the products they owned. For example, 33% of those owning ISAs or PEPs (tax exempt savings vehicles that are invested in equities) said they were not prepared to take any risks with their money.²⁶ Overall, the research found that minimal importance was attached to regulatory risk warnings.

b) Barriers for the Regulator

Barriers to regulators acquiring knowledge are no less significant, but much less frequently discussed in the literature. Regulators face a range of difficulties in acquiring knowledge about consumers skills, knowledge, behaviour and needs. These are principally:

- Differentiating between consumers
- Communicating with consumers

Differentiating Between Consumers

For the regulator, metaphorically looking out over a mass of investors, the 'retail investor' can be a very hard character or set of characters to pin down. Retail investors are incredibly diverse, and often a rather vague and ill-defined group, often described by regulators as 'an amorphous mass', or a 'discombobulated group of individuals out there'.

²⁴ P. Slovic, *Perceptions of Risk*

²⁵ N. Boyd, *Eron Mortgage Study* (Vancouver, 2005).

²⁶ *Financial Capability: Baseline Survey*, CRPR 39 (FSA, 2006), p. 20.

Without more specific knowledge about the ways in which retail investors differ, the danger is that regulators use a substitute. That substitute may be a constructed caricature. For Professor Gower, the architect of the regulatory regime introduced in the U.K., that figure was Aunt Agatha. Aunt Agatha was an elderly lady, implicitly a spinster, possibly from Scotland (and therefore in possession of a canny and thrifty nature), who was reasonably knowledgeable but not a financial expert. She was, he argued, the type of person the rules should be aimed at protecting; in his words, ‘reasonable people who should not be made a fool of’.²⁷

More often, however, the substitute is the regulator him- or herself. Regulators are people, and they are also investors. They have friends who invest, and friends of friends. There can be an assumption, therefore, that they can step into the shoes of the retail investor, that the regulator does not need to actively seek knowledge about the retail investor, because they themselves are one. They also read the papers, they talk to people. Moreover they may also have a specialist knowledge of securities law and/or finance acquired through extensive years’ experience.

This ‘life knowledge’ is often what regulators draw upon when they talk about investors’ skills, knowledge, behaviour and needs. As one regulator commented:

‘We’re obliged to protect the investor, but .. we’ve been prepared to stand in place of the investor more than we should..... We’ve been prepared to substitute our views for the investor on a fairly regular basis.’

Another commented:

‘There has been an assumption that we know what the retail investor needs, more than there perhaps should have been.’

Communicating with Consumers

Regulators have a variety of ways of communicating with investors, discussed below. But all find that communicating with consumers is difficult, particularly if the regulator has not found a way of differentiating between target groups. The following comments are representative of those made by

²⁷ See J. Black, *Rules and Regulators* (Oxford, 1997).

regulators in the course of this research:

‘Communicating effectively with an amorphous, undifferentiated mass of individuals at a time when they need to hear is very difficult. Because that’s just what it is, an undifferentiated mass. There is no ‘retail investor’, just individuals who at some point in the cycle may just want to hear from you; [each] may be looking, but it’s very hard to find each other.’

‘They [retail investors] are very hard to get at. Not like the institutional investors – we know who they are, or the lawyers. They’re all very well organized and very vocal. But how to go out to the average investor in the street and talk about it? And do they care? They don’t care about the rules and regulations; they just want to know whether they can get their money back. We have to talk to them about what is relevant.’

‘It’s a particular challenge engaging retail investors – we just don’t have the right channels of communication with them. It’s not for want of trying.... But people have lives to lead, families – other things to do than respond to our comment papers.’

‘We have problems getting retail investor views. Retail investors don’t know we are relevant to them. There is no good aggregator of retail investor views that we can turn to, in contrast to the industry, where they have organizational structures to canvas members, get documents together and so on’.

v. Summary

Consumer-regulatory involvement can thus take four main forms: information, education, consultation and participation. These are on a continuum from passive engagement through publication of annual reports or rule changes, to active participation in setting the agenda and shaping the policy proposals. Consumers and the wider public can be involved at any stage in the regulatory process: design, implementation, enforcement and evaluation. However, as the degree of active engagement increases, the number of potential consumers involved decreases.

The key to effective consumer-regulatory involvement is knowledge on the part of both consumers and regulators. Retail investors have to know about the regulatory regime if they are to be able to be effectively involved in it. However, consumers are generally unaware of the regulatory system, and face

significant difficulties in gaining knowledge about financial services and products. Regulators have to have knowledge about retail investors' skills, knowledge, behaviour and needs if they are to design regulations that provide them with appropriate protections, but face significant difficulties in trying to communicate with consumers to gain the knowledge that they need.

The different forms of consumer involvement are also themselves interlinked. The modes of involvement are cumulative: information and education are essential pre-requisites for meaningful consultation and participation. Further, information and education activities can equip consumers to become more actively involved, help regulators identify existing groups of retail investors, and provide entry points for more active consultation and participation strategies, which can in turn feed back into information and education activities.

Finally, although knowledge on the part of both consumers and regulators is essential for effective involvement, each faces significant difficulties in acquiring this knowledge. Consumers are hindered by low levels of financial literacy, the variety and complexity of financial products, the opaque nature of those products and services, and the difficulties of making decisions in the face of uncertainty. Regulators face difficulties in differentiating between retail investors, and communicating with them effectively. How regulators have sought to overcome these difficulties is the subject of the following sections.

5. Getting a Better Understanding of Consumers

Whilst communicating with retail investors and involving them is clearly difficult, regulators have been developing different strategies for getting a better understanding of consumers' skills, knowledge, behaviour and needs.

There are several ways in which regulators can and do get information on consumers. These include:

- monitoring calls to their contact or call centres;
- analysis of complaints;
- monitoring the media;
- communications with investor advocates; and
- research.

The standard ways of getting information have been through the complaints processes and calls to regulators' contact centres, through the media and contacts with investor advocates. However, more recently securities regulators have begun to use more focused research strategies.

This section focuses on four principal strategies:

- research;
- monitoring direct communications from retail investors and analysis of complaints;
- linking with information and education initiatives; and
- broadening the sources of expertise involved in rule-formation.

The relationship between regulators and consumer advocates is discussed in Section 8.

i. Getting Information: The Role of Research

In the last five years, regulators in Canada, Australia and the U.K. have begun to commission far more research into consumers' skills, knowledge, behaviour and needs. In turn, the role of research in providing a basis for regulators' communications strategies and indeed for regulatory policy has increased markedly.

This research is critical, as it consistently shows that there are generally low levels of financial awareness, both in Canada and elsewhere, and that consumers' patterns of knowledge, behaviour and confidence do not support assumptions that consumers are at present capable of making independent, informed choices about financial products.²⁸

The research falls into two main types:

- generic research on investors' knowledge and financial capability; and
- specific research connected with particular policy initiatives.

ii. Generic Research

Generic research in turn falls into two main categories:

- that which assesses overall investor awareness and confidence in the regulatory regime; and
- that which focuses on investors' skills, knowledge and behaviour.

a) Research on Awareness of the Regulatory Regime

Awareness and confidence research is conducted by the OSC, ASIC and the FSA. Since 2000, the OSC has conducted a series of biennial stakeholder satisfaction surveys. The fourth survey is being conducted during March-April 2006. The previous survey, (reported in July 2004), found generally low levels of awareness of the OSC or its role among the general public (e.g. only 25% awareness of the OSC; 25% awareness of the mutual fund probe). The conclusion from the survey was that unaided awareness remained low amongst the general population. Investor confidence remained strong, but was decreasing.²⁹ The OSC has also conducted a survey of mutual fund investors' confidence. The benchmark measurement was established in 04/05; next survey is scheduled to be completed in 2006, covering a broader range of investors.³⁰

²⁸ PRI, FCAC and SEDI, *Why Financial Capability Matters: Synthesis Report on Canadians and their Money* (Ottawa, April 2006).

²⁹ OSC, Stakeholder Satisfaction Survey, Wave 3, Final Report, July 2004.

³⁰ Statement of Priorities 05-06

In the U.K., the FSA has also conducted research on the public's awareness of the regulatory regime.³¹ This found that 30% of the general population were aware of the FSA, 15% unprompted and 15% prompted. A further 23% were aware there was a regulator but could not name it correctly. Awareness was much higher amongst those who had bought an FSA-regulated product: 57%. However, although awareness has increased over the last three years, this still leaves 47% of the public unaware that there is any financial regulation whatsoever.

Like the OSC, the FSA also conducts surveys that have a general question on confidence in the regime. However, although increasingly common, general questions about confidence do not tell us much about people's expectations of the regulation.³² They are thus in danger of measuring how successful the regulators' public relations team has been, rather than how effective the regulator has been in fulfilling its mandate. Further, on their own they do not measure whether that confidence is based on accurate or misplaced expectations of what protections the regulator will offer. Research by the FSA suggests that these expectations are often either vague or misplaced.

The FSA conducts periodic research on people's expectations by asking whether they expect a regulated firm to be allowed to go bankrupt.³³ The most recent research found that 35% of people felt either that no regulated firms would be allowed to go bankrupt, or only some would be allowed to go bankrupt, and 39% did not know.³⁴ More searching questions of this nature would enable regulators to find out whether the confidence that people were expressing as to what the regulator did and would do matched regulators' own powers, objectives and priorities.

b) Research on Financial Capability

Securities regulators have also begun conducting research into people's financial capability, including their behaviour. Financial capability, in a broad sense, refers to people's ability to develop the skills and confidence to be aware of financial opportunities, to know where to go for help, to make informed

³¹ FSA, *Awareness of the FSA*, CRPR 39 (London, 2005); *What Consumers Know about Financial Regulation*, CRPR 29 (London, 2004).

³² In the U.K. the Health and Safety Executive and the Food Standards Agency both use similar survey data as part of their performance assessments.

³³ Note that the FSA is also a prudential regulator.

³⁴ FSA, *Awareness of the FSA*, CRPR 39 (London, 2005); *What Consumers Know about Financial Regulation*, CRPR 29 (London, 2004).

choices, and to take effective action to improve their financial well-being.³⁵ Financial capability thus comprises investors' skills, knowledge and behaviour.

There has been very little comprehensive and nationally based work to assess financial capability in Canada.³⁶ However, some provincial Securities Commissions have started to undertake this type of research, and the recent announcement by the CSA that it will compile a national Investor Index, discussed below, is to be welcomed. To date, most of the research has been on relatively focused aspects of financial capability, such as how investors find information. In 2002 the ASC initiated a biannual research project on how Albertans seek financial information, which outlets they find more helpful and on which topics they would like to receive information, with a view to revising its investor education strategy.³⁷ The research was repeated again in 2004, and the results for 2006 are due soon. The latest survey, conducted in May 2004, revealed that the most common places for Albertans to look for information are mass media outlets, such as newspapers and the Internet. In addition, financial advisors and accountants were identified as a common source for information about investing. It was discovered that only 13 percent of Albertans consider themselves able to make well-informed investment decisions. Further, the research indicated that investors do not know where to go to obtain more information about investing, resulting in a feeling of paralysis among some investors. It identified four topics of interest on which Albertan investors said they would like information: how to avoid investment fraud; how to save for retirement; how to evaluate risk and return; and the basic investment principles.

Other research has focused on levels of financial literacy. The OSC's Investor Education Fund (IEF) used information taken from the International Adult Literacy Survey in 1995 to attempt to quantify the numbers of people who are most at risk of having low levels of understanding about investments. The research was then used as the basis of the IEF's work to help people make more effective use of financial information and apply this knowledge to reaching their investment goals.³⁸

The Investor Education Fund's financial literacy research has also looked at what causes consumers to seek out financial information. The research indicated that people are most likely to look for information when they experience key "triggering events" in their lives, such as getting married, having children,

³⁵ PRI, FCAC and SEDI, *Why Financial Capability Matters: Synthesis Report on Canadians and their Money* (Ottawa, 2006), p.1. For a similar definition see FSA, *Levels of Financial Capability in the U.K.: Results of a Baseline Survey* (London, 2006)

³⁶ PRI, FCAC and SEDI, *Why Financial Capability Matters: Synthesis Report on Canadians and their Money* (Ottawa, 2005), p.3

³⁷ ASC, Annual Report 2002, p. 7

³⁸ Cited in PRI/FCAC/SEDI, *Why Financial Capability Matters*, p.14.

getting a new job, retirement, divorce, etc. This research is the basis for the OSC's consumer outreach strategy, which focuses on reaching boomers, women, new couples and families with appropriate investor education messaging at the time they experience triggering events. The OSC focuses on lifestyle tradeshows (baby, bridal, women's health, healthy living, and home shows), and ties in its marketing and editorial campaigns using related media.

The CSA has also capitalized on the OSC and ASC research, and similar research by the Manitoba Securities Commission, to reach consumers with generic investing information at key life stages. The CSA is currently in the midst of an online campaign that reaches out to Canadians who are getting married, having children, thinking about retirement and dealing with a financial windfall, in partnership with the comic strip "For Better or For Worse".

The BCSC has also done more focused research on the investment knowledge and behaviour of a specific ethnic group, the Chinese community in British Columbia. This research fed into a pilot education program in Cantonese, formed in partnership with Vancouver-based radio station CHMB, a large ethnic radio station in Canada.³⁹

In a broader move to determine a baseline measurement of financial capability, the BCSC is currently commissioning consultants to prepare an Investor Index. This will be an annual survey of between 800-1,000 individuals in B.C to assess their investment skills, knowledge and behaviour. It will also drill down regionally to see if there are differences between the regions, such as demographic differences. This year will form the benchmark against which to evaluate changes over the subsequent years. The aim is for the Index to be focused, measurable and sustainable over a three-year period. Prior to formulating the index, the Commission is anticipating conducting focus groups with investors to try to determine what type of information is relevant for them, and what they need to know. Again, the primary aim is for the research to be fed into its investor education work, although it is anticipated that it may also be useful for policy initiatives.

In May 2006 the BCSC presented the concept to the CSA to see if the Index could become a national tool. The CSA agreed to compile a national 'investor competence index' that will be completed early fall. The Index will:

- measure a series of key investor understandings and behaviours;

³⁹ BCSC Annual Report 2004-5, p. 36.

- synthesize these findings into a single index (or series of indicators) to assess overall investor readiness;
- it will establish a 2006 benchmark for subsequent tracking studies;
- allow for cross-referencing of results by key demographic and perhaps psychographic groups;
- measure awareness of securities commissions; and
- support investor education planning, including risk profiling and target market identification.

The findings will be published as part of the efforts of securities regulators via the CSA to raise awareness of fraud and promote appropriate investing behaviour

In the U.K., the FSA and the FSA Consumer Panel have commissioned a number of research projects into different aspects of consumers' literacy, understanding of risk, and investment behaviour. All these individual pieces of research give a fairly consistent picture of low financial capability in these different areas. In 2004 the FSA decided to commission far wider research to establish a baseline against which to measure financial capability in the U.K..⁴⁰ The report, published in March 2006, assessed the financial capability of over 5,300 individuals in the U.K.. The research investigated five areas of financial capability:

- making ends meet;
- keeping track of your finances;
- planning ahead;
- choosing financial products; and
- staying informed about financial matters.

The research provides very detailed analysis of what proportion of the U.K. population perform at what level in each of these areas. The data makes it possible to correlate capability against different demographic characteristics including age, income and wealth levels, educational qualifications, geographical area, gender, religion, employment and family circumstances (e.g. in work, with dependents), and investment behaviour. The research shows the advantages in disaggregating financial capability into different components, as the results found that people are not consistently capable across all areas. For example, the over-70s are strong at making ends meet, but they are much weaker in the area

⁴⁰ FSA, *Levels of Financial Capability in the U.K.: Results of a Baseline Survey* (London, 2006), available at <http://www.fsa.gov.U.K./pubs/consumer-research/crpr47.pdf>.

of choosing financial products; the under-40s show less capability in planning ahead than the over-40s, even allowing for differences in levels of education and income. The research will be conducted again in 4-5 years, and the results will form the basis both for the FSA's National Financial Capability Strategy and also its policy initiatives on, for example, the information that consumers need from advisors, brokers and product providers to enable them to get a fair deal.⁴¹

The recent PRI/FCAC/SEDI report on financial capability suggests that the U.K. baseline survey developed for the FSA could provide a useful model that could be used in Canada. It makes several key recommendations for future action to improve financial capability, including a national research agenda. It advocates a threefold program of research:

- assess the current state of financial capability in Canada, on both the demand and the supply side;
- examine the relationship between financial capability and related areas, including basic financial literacy, financial inclusion and financial security, and document gender differences and peculiarities; and
- support innovation through investment in finding ways to improve accessibility and effectiveness of financial capability education, information and advice.⁴²

It concludes:

‘Whatever the method, the information needs of policy makers, researchers and practitioners will only be filled with a pool of data that is sufficiently broad to look at all three dimensions of financial capability across the population, sufficiently detailed to allow analysis by population subgroups (including age, income, wealth, education, region etc.), and that can be repeated periodically to analyze changes following policy and program interventions.’⁴³

iii. Policy-Specific Research Initiatives

Regulators have also begun to explore ways of building a better understanding of retail investors' needs and capabilities with a view to informing specific policy decisions. This is a welcome attempt move

⁴¹ FSA, *Financial Capability in the U.K.: Establishing a Baseline* (London, 2006), available at http://www.fsa.gov.U.K./pubs/other/fincap_baseline.pdf.

⁴² PRI/FCAC/SEDI, *Why Financial Capability Matters*, p.22.

⁴³ *ibid.*

beyond the formal, paper-based consultation process on proposed rule changes, and has been prompted by a number of factors:

- novelty of the policy proposal (research on mutual fund disclosure);
- recognition that regulation is not being effective in giving consumers the information they need in a way they can understand it (prospectus disclosure and point of sale information for mutual and segregated funds);
- the importance and significance of the policy initiative for regulators, the industry and investors (OSC Fair Dealing initiative and the CSA registration reform project);
- the degree of change that the policy will introduce in relationships between retail investors and regulated firms (OSC Fair Dealing initiative and the CSA registration reform project);
- to give ammunition against industry objections to proposals (mutual fund point of sale and continuous performance disclosure);
- to understand how investment fraud is perpetrated with a view to improving investor education programs and investor protection regulation (Eron mortgage scandal); and
- personal backgrounds of officials – those who have worked in commercial organizations are used to using focus groups as an input to decision making.

This research has taken three main forms:

- piloting;
- victims of scams; and
- impact and compliance assessments.

a) Piloting

Regulators are increasingly ‘piloting’ policy proposals on investors. Much of securities regulation has been traditionally premised on the basis of disclosure, and reliance placed on investors to respond rationally and competently to the information that they are given in choosing which investments to make, and through which brokers or advisors. The effectiveness of many policies in securities regulation is thus dependent on whether or not investors read these disclosures, understand them and make use of them to inform their decisions.

Increasing awareness that consumers lack the financial capability to make those decisions has led regulators to recognize that there is a knowledge gap – they need to find out from consumers directly what they can and cannot understand. As one official commented,

‘There’s not much point sitting in an ivory tower making up regulation we truly think is in the best interests of investors without actually asking them.’

The research methods used range from interactive web-sites through to focus groups. When it launched its Fair Dealing Model in 2002, the OSC used an interactive website that used the latest animation software to bring client-advisor relations to ‘virtual life’.⁴⁴ Three streams of advice were illustrated: the ‘managed for you’ relationship, on which the primary responsibility is on the advisor; the ‘advisory relationship’, in which the responsibility is shared between investor and advisor; and ‘the self-managed relationship’, which puts primary responsibility on the investor. The website allowed investors to explore on-screen the relationship they would be most comfortable having with their advisor. The site also gave tangible examples of how advisors could deliver services under the new model. The virtual characters demonstrated how clients in the three streams would be introduced to the firm, examine compensation schemes, and identify rights and responsibilities. The site also provided generic on-line documents that firms could use in the new relationships, including ‘inform your client’ documents giving generic information on equities, mutual funds, bonds and investment risk. A sample Fair Dealing document was also provided that set out what services investors could expect under each model and the fees they would have to pay. The brainchild of the OSC’s senior legal counsel at the time, the site received 10,000 hits. A relatively small proportion of individuals, submitted comments, (300) and 20% of those were from individual investors.⁴⁵ Although the overall numbers of individual investors offering comments is small, at roughly 60 people, this is considerably more than would ever respond to the formal consultation processes.

The more usual method of piloting has been to use focus groups. The AMF has conducted focus groups to get feedback on the information provided to retail investors. The Alberta Securities Commission has also engaged in focus group discussions on proposed changes to the prospectus and exemption rules,⁴⁶ and the recent corporate governance initiatives.⁴⁷

⁴⁴ http://www.osc.gov.on.ca/About/NewsReleases/2002/nr_20021008_osc-fair-dealing.jsp.

⁴⁵ OSC Annual Report 2003-4.

⁴⁶ MI 45-103, now MI 45-106.

⁴⁷ National Instrument 52-109, MI 52-111.

Most of this type of research has been connected with disclosure requirements and the Fair Dealing initiative, which has now developed into the broader CSA registration reform project. In 2002, the OSC, with the BCSC, commissioned research into consumers' understanding of the information given to them on an on-going basis about the financial and non-financial aspects of an investment fund (continuous disclosure and mutual fund reporting).⁴⁸ The research also questioned people on their ideal form of reporting in terms of content, formatting and frequency, and examined the likely impact on their behaviour of certain changes in reporting. These findings fed into the significant revisions of the rules on continuous disclosure and fund reporting introduced in 2005 by all the securities regulators.⁴⁹

Other focus group research projects of this nature are being planned in connection with the CSA registration reform project and the mutual fund point of sale project.

The point of sale project focuses on the information mutual fund and segregated fund holders receive at point of sale. It is a CSA and Joint Forum of Financial Market Regulators project. The CSA side of the project is being led by the OSC and the BCSC. Its aim is to get more concise, clear and relevant disclosures to retail investors in both types of funds at the point of sale. The disclosures will be tested in 3-4 locations across Canada, including Quebec, to see if there are regional differences that need to be taken into account. As focus group research is expensive, the questions need to be well framed and any proposed disclosure templates need to be well-researched. Regulators are therefore talking to consumer advocates and others as to the form that the disclosures should take before they are focus tested. The project is complicated by jurisdictional issues: segregated funds are essentially mutual funds in a life insurance wrapper, and are regulated by the insurance regulators. Coordination is thus at a premium.

It is also anticipated that proposals from the SRO rule committee of the CSA on the registration reform project will be focus tested. If this goes ahead, this will be the first time that any of the SROs have engaged in this form of consumer research.

⁴⁸ Compas, *National Instrument 81-106: Final Report for the Ontario Securities Commission* (May 2003), available at http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/rule_20040528_81-106_survey-rpt-en.pdf. The research found weak levels of satisfaction with the reports that were currently being given under the regulatory requirements, and low levels of readership. The main reason given for simply skimming the report was that the investment was a long term one (85%), and / or the person did not have time (75%). However, a significant number of respondents said that the reports were too long (68%) and too difficult to understand (48%). Further, the research found that perceived weaknesses in reporting (length, comprehension) were the only factors that were related statistically to reading intensity.

⁴⁹ National Instrument 81-106.

b) Victims of Scams

By its nature, ‘piloting’ research is forward-looking: it focuses on how consumers would behave under a proposed regulatory regime. In contrast, research into victims of scams seeks to understand why scams succeeded – why people invested in them. ASIC has commissioned work of this nature, and in 2002 worked with investors in an international cold calling scam. The research asked investors what had prompted them to invest in the scam, with a view to informing its education initiatives and scam warning systems.⁵⁰

In 2005 the BCSC commissioned a similar type of research into victims of the Eron mortgage scam. The research questioned victims to try to understand why they had invested in the scam.⁵¹ This research was motivated by a desire on the part of the regulator to understand why so many investors had been taken in by the scam for so long.

The research findings came as a surprise to the Commission. The research found that most of the investors were men in their 50s, pre-retirement, who were looking to fund their retirement. They were of average wealth, with average educational background. However those who described themselves as more knowledgeable in fact lost the most amount of money. Most took money from their existing retirement funds, borrowed money and / or mortgaged their homes to participate in the scheme.

Two key findings have had a significant impact on the BCSC’s current work. The first finding is the identification of two types of vulnerable investor on whom the BCSC had not previously focused. These are pre-retirement investors who are approaching retirement without adequate funds and who are anxious to maintain their lifestyle post-retirement, and the affluent middle-aged male, who is assumed and assumes himself to be knowledgeable about investments.

The second finding is the economic and social impact that financial loss, and being the victim of fraud, can have on individuals and society. More than half of those who lost more than \$50,000 reported extreme or major harm to their emotional well-being, their current financial situation, and their retirement security. Between 20 and 30 percent of these investors also reported extreme or major harm to their marital relations, friendships and physical health.

⁵⁰ ASIC, *Hook, Line and Sinker: Who Takes the Bait in Cold Calling Scams?* (2002), available at www.asic.gov.au.

⁵¹ Neil Boyd, *Eron Mortgage Study* (Vancouver, April 2005), available at http://www.bcsc.bc.ca/uploadedFiles/Eron_Research_Study.pdf.

The impact of the research has been mainly on the investor education program. As noted above, it has prompted the Commission to completely re-think its investor education strategy, and to compile the Investor Index to provide a basis on which to develop a targeted and focused program based on a sound understanding of investors' skills, behaviour and understanding. As yet, it has had less far-reaching impact on policy making, although the Eron mortgage fraud itself did prompt a change in the exemption rules for mortgages.⁵²

c) Impact and Compliance Assessments

The third main type of research that has been conducted is into the impact of securities regulation on the behaviour of investors and / or regulated firms. For example, the ASC and BCSC's Capital Market Project considered the impact of the introduction, in March 2002, of several new and broader exemptions for the issuance of securities, designed especially for small and medium sized issuers. The goal of introducing the new exemptions was to improve access to exempt financing for both issuers and investors, and the Commissions consulted with industry through focus groups and information sessions to acquire views and comments more directly.⁵³ Both the ASC and BCSC monitored use of exemptions after the changes had been introduced. The ASC published a study using the gathered exemption information that tested whether that goal had been met by comparing exempt equity financings in 2002 and again in 2004, after the new rule was introduced. It found that there was a significant increase in capital raised in the exempt market, and an increase in the percentage of capital raised by small- and medium-sized issuers pursuant to exemptions.⁵⁴

Research can also form part of compliance and enforcement activities. For example, both ASIC and the FSA have engaged in successive 'mystery shopping' or 'shadow shopping' exercises as part of their compliance and enforcement work. Mystery shopping is designed to reveal whether or not investment advisors are in fact complying with their regulatory obligations. Researchers pose as consumers seeking financial services and products, and report on the conduct of the investment advisor. That information enables the regulator to assess levels of compliance on the ground far more directly than any audit of a firm's processes could reveal. Partly at the continued insistence of the Financial Services Consumer Panel,⁵⁵ the FSA has now conducted four mystery shopping projects with respect to different products in

⁵² The change occurred prior to the report being conducted.

⁵³ BCSC Annual Report 2001-2.

⁵⁴ ASC, Annual Report 2002-3.

⁵⁵ See FS Consumer Panel

2005-6.⁵⁶ In Australia, ASIC has conducted mystery or shadow shopping surveillance research on the advice given by financial advisors on switching between superannuation / pension plans. It used the findings of the research to issue a guide to advisors on what information and advice they should be giving.⁵⁷

Research is expensive, and clearly resources need to be targeted at the key regulatory initiatives that have, or are going to have, the greatest impact on retail investors. As one official commented, ‘not every rule comes with this type of budget’. There is an increasing amount of research being conducted by the Canadian Securities Commissions, nonetheless, although it is not always reported or easy to find. Thus far the SROs have not embarked on this kind of work, although as noted above, this may soon change.

The quantity of research is still far less than is being done in other jurisdictions, however. For example, in the U.K., the FSA has conducted forty-seven research projects since 2000, nearly twenty of which could be classified as ‘piloting’ policy proposals since 2000. ASIC has been much less active in this respect but the trend is in the same direction. Nonetheless, securities regulators in Canada are recognizing that focused research can be a valuable way to fill the knowledge gap, and to facilitate consumer involvement in the regulatory process.

iv. Complaints and Contact Calls as Sources of Information

Research on consumer responses and specific needs is a novel exercise for securities regulators, and expensive. A more traditional and less costly source of information for regulators is the complaints system and regulators’ contact centres. Regulators do not investigate individual complaints against regulated firms, which are dealt with by OBSI. Nevertheless most regulators have systems for collating data on calls received by their contact centres, though these vary in the level of analysis that they provide. All regulators considered in this report had systems for passing complaints onto their investigations and enforcement division to see if further action should be taken. Some are more systematized than others, however. The ASC, for example does not keep statistics on calls it receives in its call centres; the BCSC, the AMF and the OSC track and analyze this data; and RS is developing systems to enable it to do that.

⁵⁶ FSA, *Mystery Shopping Results – Depolarisation Disclosure* CRPR 48 (London: 2006); *Mortgage Disclosure – Mystery Shopping Research Report* CRPR 42 (London: 2005) *The Sale of Payment Protection Insurance – Mystery Shopping Results* CRPR 45 (London, 2005); *The Sale of Self-Certification Mortgages – Mystery Shopping Results* CRPR 46 (London, 2005). All reports are available at http://www.fsa.gov.U.K./Pages/Library/Other_publications/Consumer/index.shtml.

⁵⁷ ASIC, *Super Switching Guide* (2005); the shadow shopping report is available at http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/Reports?opendocument.

This data is being used by regulators mainly for two purposes: to inform their strategies on informing investors about the regulatory system and their role in it, and to feed into their investigative and enforcement work. At the OSC, for example, there is a triage system, whereby complaints about a regulated firm's conducts are given a high-level review by a senior enforcement official. That person then decides what course of action needs to be taken, ranging from full investigation, to cautions, to facilitating a settlement, to a decision that no action is warranted.

A bunching of complaints in particular areas can trigger a bigger review. Scholarship plans have been an issue in both B.C and Ontario, and both securities commissions there have initiated reviews in this area. As one OSC official commented, without the complaints data, this would have been an issue that probably would not have been on OSC's radar screen. Indeed the BCSC has initiated a wider review of suitability complaints for scholarship plan dealers, IDA member firms, and MFDA member firms, and will analyze this data for patterns and trends including: the type of product, common client profiles associated with suitability issues and concentration in a particular industry segment, geographical area, or registration category, with a view to taking further action.⁵⁸

The IDA gains information through its electronic complaints, reporting and settlement system (ComSet). Regulated firms are required to report to the IDA certain events, such as investigations against them by other regulators; civil actions; arbitrations; litigation settlements entered into with clients; and complaints. The enforcement department will use the ComSet file in its decisions on whether to open an investigation file. With respect to complaints data, the IDA has a 1-800 number responded to by its Complaint Centre. The IDA is beginning to develop systems for collation and aggregated analysis of the complaints data it receives, looking at the nature and frequency of each type of event. It is also conducting a more granular analysis of suitability complaints. This is one of the biggest types of complaint, but can cover a wide range of things: poor advice, a poor or unsuitable product, or just a 'complaint of convenience' as the complainant did not know how else to describe the complaint. The aim, therefore, is to try to break the suitability complaints down to develop a policy approach that will reduce the number of complaints that are arising. Further, complaints data has also prompted a policy initiative on firms' internal supervision of their sales forces.

RS is also starting to analyse the calls and complaints it receives more closely to see what people do and do not understand about its role, to inform future redesign of its website. The AMF and the MFDA also

⁵⁸ BCSC, Service Plan 2006-9.

monitor complaints as to their nature, frequency and number over time. Policy initiatives can be prompted by high incidences of complaints, particularly where large sums of money are involved. Examples include the MFDA's notice on outside business activity,⁵⁹ which requires all authorized persons to deal through their authorized dealer. Non-securities related business may be conducted outside the authorized dealer provided certain conditions are met, which includes obtaining the approval of the authorized dealer. The notice was issued reinforcing the regulatory requirement after a significant number of complaints were received about people losing money when securities and other investments were sold by authorized persons outside their dealer. A further example is in the area of personal financial dealings, where authorized persons were borrowing from clients and engaging in private investment schemes with clients without the knowledge or consent of their authorized dealer. A notice was issued reminding authorized persons and dealers of their obligations under MFDA rules.

a) The Role of Complaints in Providing a Benchmark for Evaluating Compliance Monitoring

Consumers can therefore play a significant role in shaping regulatory behaviour, if in fact they complain to the regulator. As noted above, however only a small proportion of retail investors that feel they have a complaint about a financial product will actually complain to firms, and even fewer will take the issue to the Ombudsman.

The role of complaints in making regulators aware of problems that they would not otherwise have known about is valuable, but it does call into question the effectiveness of regulators' own monitoring and compliance processes. In a novel initiative, the BCSC has recognized this, and has taken the matter one step further. In its Service Plan for 2006-9 it proposes to assess annually the percentage of cases initiated by complaints in its case assessment or compliance branches to see what percentage it could have detected earlier with better internal compliance monitoring (the baseline figure is 7%). Over the coming year, it proposes to test a more effective measurement for early detection. No other jurisdiction appears to have a similar measurement.

BCSC is also establishing an Emerging Issues Committee, composed of all those within the Commission who may have intelligence on these issues, such as complaints, corporate finance, to look at new products, engage in risk profiling, purchasing patterns and so on, to see if there is action it should be taking, such as issuing investor alerts, conducting compliance reviews and so on.

⁵⁹ Member Regulation 40.

v. Linking to Investor Information and Education Initiatives

As discussed in Section 6, the securities commissions all have active investor education and information initiatives. Many of these involve going into workplaces, working with community groups, educational institutions, and attending a wide range of events to try to raise consumer awareness of the regulator and improve financial capability.

Developing partnerships with a wide variety of groups on informing and educating investors could provide an entry point for regulators to develop more consultative and participative relationships directly with retail investors. At present, although there are links between the education initiatives and policy development, this is often by policy staff working with information staff to ensure the right investor alerts are issued, for example on scholarship plans.

The relationship could work the other way, however. Feedback from education initiatives can be valuable for policy staff, and indeed information and education initiatives could in some cases be developed into consultative forums. It is notable that BCSC, for example, is hoping that through its revised education initiatives to develop contacts with groups, it could then consult on more specific policy initiatives. Expanding direct contacts with retail investors through these routes can avoid the expense of focus group research, and be a valuable supplement to the formal comment processes.

vi. Broadening the Range of Expertise Involved in Policy-Making

Finally, regulators have started to broaden the range of expertise that is used in policy making in an effort to better understand and communicate with retail investors. In the U.K., the FSA commissioned work from decision theorists and psychologists as part of its *Consumer Needs* project to understand how consumers make decisions about financial matters, and what ‘life events’ trigger people to engage with financial services. This research suggested, for example, that the times people are most likely to decide to enter the financial markets are when they get married, have a baby, or a close relative dies. Giving financial generic information at bridal shows, baby shows, in bereavement parlours is thus most likely to reach consumers at the appropriate time. The OSC has conducted similar research and used it to shape its outreach policy. Indeed, the ‘Programs and Events’ section of the OSC website announces that OSC representatives will be attending a three day ‘Baby Time Show’ in Ontario in May. The CSA also focuses its investor education initiatives around ‘life events’.

Canadian securities commissions have also started to work with plain language specialists in an attempt to understand how consumers read, and therefore what it is they are likely to understand.⁶⁰ This initiative was launched in B.C, where they revised their entire securities legislation in plain language, although implementation has been delayed by the provincial government until December 2007.⁶¹ But the idea has spread, and both the OSC and the ASC have employed a plain language consultant to help them improve their communications with investors. This initiative is not confined to investor information and education campaigns, but extends to their policy-making as well. Thus in OSC, their plain language specialist is working with staff on the point of disclosure project to develop disclosures that retail investors will be better able to understand.

vii. Summary

Regulators in Canada, the U.K. and Australia are thus using different strategies to get information on retail investors. These are principally:

- research, both generic and specific; and
- monitoring contacts and complaints.

In addition, some regulators are either using or developing strategies that:

- leverage off information and education initiatives; and
- expand the sources of expertise involved in policy making.

Most of these strategies are recent, within the last 3-4 years, and / or have become more systematized. Some strategies, particularly research, offer considerable scope for inter-regulatory collaboration especially on generic issues such as financial capability and on national policy initiatives. However some strategies are more developed than others, and the pattern of usage is quite varied between the regulators. A number of recommendations can be made as to how strategies for obtaining information on investors can be enhanced. Because of the variation between regulators, some of these are more relevant for some regulators than others.

⁶⁰ Plain language is a recognized form of drafting legal, governmental and other publications in a way that is clear, simple and easy for the reader to understand. For details see the Plain Language Association International (sic) (PLAIN) at <http://www.plainlanguagenetwork.org/>.

⁶¹ See BCSC Annual Report 2004-5; BCSC News Release, 10th February 2006.

viii. Recommendations

Getting Information on Consumers

Recommendation #1.1: Proceed with the development of a national Investor Index on retail investors' skills, knowledge, needs and behaviour as a matter of priority. The database should enable analysis across different demographic groups. The research should be repeated on a 3-5 year basis.

Recommendation #1.2: Integrate the findings of research into all communication, education and policy initiatives concerning retail investors.

Recommendation #1.3: Expand the use of consumer research with respect to specific policy initiatives where these have a significant impact on retail investors, including research into the dynamics of the advisory / sales process, experiences of the complaint processes and consumer understanding of disclosures.

Recommendation #1.4: Develop consumer research methodologies to evaluate the impact of existing and new policy initiatives on retail investors. Where policies are harmonized across jurisdictions, the research should be done on a collaborative and / or national basis as far as possible.

Recommendation #1.5: Develop consumer research strategies as part of the compliance process, e.g. through routine mystery shopping exercises.

Recommendation #1.6: Use information from complaints databases, including OBSI's complaints data, systematically to inform policy initiatives.

Recommendation #1.7: Publish the findings of all research initiatives in a systematic, accessible and timely manner.

6. Informing and Educating Consumers

Getting information about consumers is a necessary condition for effective involvement. This section considers two aspects of that involvement – informing and educating consumers.

As discussed in Section 3, communicating with retail investors is difficult. Consumers are an amorphous group, rarely organized into effective or comprehensive representative or advocacy groups. However, people do form groups in their day to day lives, and the most successful campaigns are those that have keyed into those groups.

This section considers:

- the relationship between information and education;
- the key means of delivering information and educating retail investors, including:
 - web-based initiatives;
 - using the media;
 - conducting scams;
 - curriculum development; and
 - working with community groups.
- the role of research in designing information and education campaigns; and
- assessing their effectiveness.

Whilst information and education have often been distinct from policy making, in practice there is the potential for the different modes of involvement to be more strongly linked, and in particular for information and education campaigns to be a way in which regulators can determine the views and needs of retail investors.

i. Information or Education?

Information and education initiatives can take any one of three distinct but related forms:

- provision of ‘navigational’ information about the regulator and the regulatory system: the regulator’s remit, where to go for help, how to seek redress;
- provision of information and generic advice about financial products and services; and

- actively educating investors by enhancing their financial capability.

The regulators vary significantly in the methods they use. The SROs focus mainly on ‘navigational’ information: giving information on themselves and on how to navigate the regulatory system – where to go for help, or how to complain or seek redress. This is important information, but they have not sought to go further themselves, although they do engage in education initiatives for retail investors via the CSA.⁶² RS is to some extent an exception. Its ‘restricted fund’, funded through fines received, has a number of permitted spending categories, including investor education, although no money is reported in their quarterly reports as having been spent on this in the last 2 years. RS is however currently developing an educational package for retail investors that will roll out in the fall of 2006. This will focus on explaining what RS is, its role, and how its rules impact on retail investors. This is partly investor education, but also partly compliance education, as some of the rules affect what retail investors can and cannot do (e.g. set up wash trades between dealers). Again, this is important, but not the same as providing generic information and education in financial products, services and decision making. It should be noted that all new initiatives will now be subject to the merger between the RS and the IDA, announced in April 2006.⁶³

The Securities Commissions engage in all three types of information and education activities. In all cases, these initiatives are funded out of settlements received by the Commissions in their enforcement activities.

Both the AMF and the OSC have set up separate bodies to run their investor education work.⁶⁴ The AMF has set up the Fund for Investor Education and the Promotion of Good Governance, which supports initiatives in four areas, including investor education, and gives grants for research projects in these areas.

The OSC has set up the Investor Education Fund to run its information and education work. It operates separately from the OSC with its own Board of Directors. It develops web-based tools and resources on financial products, relationships with financial advisors, and financial decision making. The IEF also provides resources for teachers to use in financial education courses in schools, and provides financial support to non-profit organizations that offer investor education programs that tie in with the IEF’s own

⁶² The IDA has been active in the education of financial professionals, however. It founded the CSI, later in conjunction with the TSE and ME. The CSI focuses provides training for financial professionals, and has also advised governments, companies and regulators on investor education.

⁶³ IDA Report, Spring 2006.

⁶⁴ For the AMF, this is the Fund for Investor Education and the Promotion of Good Governance.

objectives. For example in 2004-5 it sponsored the production of investor education information in Braille and in six different immigrant languages, and partnered with the policy and Toronto's Advocacy Centre for the Elderly to educate community police and care workers on the dangers of financial abuse to the elderly. It also partnered with human resources and small business associations to raise awareness of its education initiatives on pension decisions, and developed a tool kit for use by pension plan administrators.⁶⁵ The IEF operates in addition to the OSC's own education and awareness initiatives, such as its staff ambassadors' program, discussed further below.

Further, as noted in Section 5, the CSA has developed its own investment education initiatives, including its 'this is your life' campaign and its initiatives in conjunction with the comic strip 'For Better or For Worse'.

ii. Key Means of Delivery

a) Web-Based Initiatives

All regulators rely heavily on their websites to inform investors. The ASC redesigned its website in October 2003 after research conducted by the ASC suggested that Albertans wanted to receive information about investing online. This was accompanied by a public awareness campaign directed at 25-34 year olds directing them to the new website.⁶⁶ Both RS and the IDA are currently revising their websites to make them more relevant for retail investors. In the U.K., the FSA is proposing to use the findings of its financial capability research to overhaul its website in 2006-7, and aims to double the annual number of visits to the website to 4 million.⁶⁷

The OSC and the ASC now have dedicated investor education websites which, like those of the FSA and ASIC, contain information on how to avoid scams and how to invest. The FSA, ASIC and OSC sites also contain generic information on investment products.⁶⁸ Of note is ASIC's 'Pie in the Sky' award, which goes to the 'most outrageous financial scheme that's too good to be true'.⁶⁹ The OSC and the FSA also have interactive sites that include quizzes, worksheets, decision trees, calculators, and advice on how to

⁶⁵ See IEF, Annual Report 2004-5, available at http://www.investored.ca/en/aboutus/IEF_Mbook_2005.pdf.

⁶⁶ ASC, Annual Report 2004.

⁶⁷ FSA, *Financial Capability in the U.K.: Delivering Change* (London, 2006).

⁶⁸ See <http://www.fido.asic.gov.au/fido/fido.nsf>; <http://www.fsa.gov.U.K./consumer/>; <http://www.investorED.ca>.

⁶⁹ See <http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/Pie+In+The+Sky+Awards+?openDocument>.

work with financial advisors. The CSA also has an interactive ‘financial IQ test’ for investors, aimed at youth.

The BCSC, the OSC and the ASC have web-based and email investor alerts, warning investors of the risks surrounding particular new products or scams. In April 2006, the BCSC started a proactive campaign to push the alerts out to the media and a launched an email subscription service for its investor alerts. The OSC alert program has been in place for 2 years, and alerts are distributed to a growing list of consumers, media and industry. The OSC proactively markets messages to the media and encourages consumer newsletters to pick up the content.

Finally, the FSA has experimented with using different distribution channels for its information, rather than relying on its own website. In July 2005 it launched a web-based ‘financial healthcheck’ on its website and that of the BBC simultaneously. The healthcheck on the BBC site received over double the number of hits compared to that on the FSA site. This is a series of multiple choice questions about a person’s personal and financial situation, which takes less than two minutes to complete. Questions include whether you think you will have enough to live on in retirement, whether you think you and any dependents would cope financially if your partner died, how well you can meet your monthly debt payments. Based on the answers, the website then offers basic advice for what you should be doing with your money, and suggestions on the types of information you need, and links to it. It has been used by over 450,000 consumers since its launch in July 2005.⁷⁰ It has also introduced a ‘money laid bare’ initiative, which gives information in a quirky, user-friendly format on topics including mortgages, and in summer 2006, pensions.

b) Using the Media

Using the media is an alternative channel to distribute information about investments and regulatory activities. All the regulators use the media to try to push out information, often focusing on enforcement actions, but also more general information and investor alerts. For example, the IDA has an active strategy of informing journalists on a weekly basis of forthcoming hearings or other events; the BCSC’s investor alert program has been mentioned above. The IDA has also tried using generalist magazines to publish information about its role, such as *Canadian Living*, or mailings to members of CARP, and OSC have tried using the general media to raise generic awareness about investments and also particular policy

⁷⁰ www.bbc.co.U.K. and www.fsa.gov.U.K..

initiatives, such as their point of sale initiative.

The media is clearly an important resource, but research suggests that the information really needs to get out of the specialist financial pages and programs for it to be widely read. The U.K. baseline survey found:

The mass media are clearly important in providing information about financial matters. Two in five respondents (41 percent) followed financial indicators by reading the general sections of the newspaper. Similar proportions kept up to date through television or radio programs. This indicates that most people hear and absorb information about financial matters whilst reading, watching or listening to other things that interest them.

In contrast, they are far less likely to use media specifically designed to give them information about financial matters. Only half as many respondents (19 percent) said they monitored things by reading the financial pages of the newspaper, and just seven percent of respondents followed specialist programs on television or radio. It is noteworthy that virtually the same proportions kept up to date via the internet as read the financial pages of the newspaper (18 percent and 19 percent respectively).⁷¹

c) Conducting Scams

Australian securities regulators have had the most significant initiatives in this area. The Australian Securities Commission (ASIC's predecessor) used to launch some scams on April Fool's day, including bluebottle farms with a guaranteed rate of return of 50%, and a scheme to cross breed Angora sheep and goats to produce Angora Geeps. A third scam was the sale of parcels of airspace over Sydney airport. Investors were promised that they could earn huge 'fly-over fees', and asked investors to send in money so that they could receive their 'airspace' rights. When investors sent in their money, their cheques were returned to them by the Commission with a letter telling them that they had been duped, and how to avoid the same thing happening again.

⁷¹ FSA, *Financial Capability in the U.K.: A Baseline Survey* (London, March 2006), pp 115-116.

d) Curriculum Development

A less eye-catching, but a more long-term initiative, is curriculum development. Making sure information and education initiatives reaches consumers at the right time and in a way in which they can use and will change their behaviour are key problems in any investor information and education work. Schools, workplaces and community groups are an obvious target for many investor education campaigns, and many of the Canadian Securities Commissions have initiatives that link with these groups.

Curriculum development has been a particular focus. The BCSC has worked with the provincial government to develop a comprehensive curriculum and all teacher support materials, including multi-media materials, for teaching and learning about financial matters (Planning 10).⁷² This is a mandatory program for all Grade 10 high school students. The ASC works with Mount Royal College in Calgary to offer non-accredited investor education courses, and provides teachers with materials to support curriculum teaching on financial awareness and investments.⁷³ The IEF provides teachers with training resources to use in the classrooms, tied into Ontario curriculum requirements.⁷⁴ In Australia, ASIC has been conducting a survey of existing financial literacy education in schools with a view to developing curricula and teaching resources.⁷⁵

In the U.K., the FSA has already piloted initiatives with higher education institutions to provide them with toolkits and training programs in personal financial education. For school-age children, the FSA and the Personal Finance Education Group are together working with curriculum policy makers to develop courses on personal financial education and provide teaching materials, tools and training free to schools. This will be introduced into the National Curriculum in 2008. The FSA is also working with a TV production company to make four programs on personal financial education that teachers can download. Over £15 million will be spent on this in the next five years.⁷⁶ This work will be informed by findings of research it has commissioned into how much personal financial education is currently delivered in schools, and will use this to inform curriculum development.⁷⁷

⁷² See BCSC Annual Report 2004-5.

⁷³ ASC, Annual Report 2005.

⁷⁴ IEF Annual Report 2004-5.

⁷⁵ ASIC, *Consumer Education Strategy 2001-4*.

⁷⁶ FSA, *Financial Capability in the U.K.: Delivering Change* (London, 2006).

⁷⁷ The research is being conducted by the National Centre for Social Research, and results are due to be published in May 2006.

e) **Engaging in Other Fora: The Workplace, Community and ‘Hard to Reach’ Groups**

Workplaces are other obvious places where people are organized into groups that regulators can key into. The ASC, OSC and BCSC engage directly with workplaces and the community. They each have staff ambassador programs in which staff members visit community groups, workplaces or other venues to give generic advice on how to invest, avoid scams, or plan ahead financially.

BCSC, ASC and OSC all participate in specialist investor forums and seminars, and with broader community groups. Reaching seniors is a particular aim for many of these programs. BCSC and the OSC have also linked up with the Probus and Rotary clubs as a way of accessing retail investors.

Working with community groups and those who deal with people who are hard to reach through the normal initiatives can be important strategies. In the U.K., the FSA has developed training programs for those working with ‘NEETs’: ‘Not in Employment, Education or Training’. It has linked with organizations and charities working with vulnerable and hard to reach young people to develop toolkits and training to engage young people in relevant and creative ways, which are currently being piloted and evaluated.⁷⁸

In Canada, one notable initiative is the BCSC’s work with God’s Fraud Squad to counter affinity fraud amongst religious groups in B.C.⁷⁹ The Fraud Squad consists of two pastors, one Protestant and one Catholic, who worked for the health authority in the Fraser Valley. They approached the Commission after realizing that many of the people they were ministering to had become ill after they had lost money through fraud and scams. Moreover, many of the people affected had met the fraudster either directly or indirectly through people they had met at Church. They have started to put on seminars for their congregations to talk about investing: how to identify suitable investments, how to avoid scams, and so on. The Commission is expanding the initiative by working with trainees in theological colleges, so they can continue investor education initiatives with their congregations.

⁷⁸ FSA, *Financial Capability in the U.K.: Delivering Change* (London, March 2006).

⁷⁹ Affinity fraud is number 8 in the North American Securities Administrators Association (NASAA)’s ‘Top 10 Threats to Investors’: http://www.nasaa.org/nasaa_newsroom/current_nasaa_headlines/2719.cfm. The BCSC has issued a publication advising investors how to avoid affinity fraud: <http://www.besc.bc.ca/now.asp?id=2076>. The SEC and ASIC have also issued similar publications: <http://www.sec.gov/investor/pubs/affinity.htm> (SEC) and <http://www.asic.gov.au/fido/fido.nsf/byheadline/affinity+fraud+can+it+happen+to+you?opendocument> (ASIC).

f) The Role of Research in Designing Information and Education Campaigns

Research is clearly fundamental to designing information and education campaigns, and as discussed in Section 5, regulators are increasingly using research for these purposes.

The ASC used the findings of their 2004 biannual survey of Albertans to launch their new information and education campaign in 2005. In BCSC, the research on the Eron mortgage scandal has caused them to completely overhaul their investor education program. The OSC's research on what causes investors to seek out financial information was used as the basis for its outreach initiatives. In the U.K. the FSA is using the findings of its Baseline survey to overhaul its financial capability strategy, and is committing £10 million to its investor education campaign in 2006, in addition to the money being spent on curriculum development.

g) Evaluating the Impact of Information and Education Activities

To date, there has been little formal assessment of this nature, and indeed, a recent OECD report on investor information campaigns found that there was limited data on their success in many OECD countries.⁸⁰

However, the FSA and the BCSC are beginning to develop performance measures to assess the impact of their information and education campaigns.⁸¹ The OSC also evaluate how much information has been retained by those who attend its seminars.

The OECD report did also have a number of recommendations for successful information campaigns, many of which are echoed in the work currently being done by some of the securities regulators.

The report found that successful information or social marketing campaigns all shared some common characteristics. They all:

- try to change behaviour by giving clear courses of action to address the problem;
- identify and communicate benefits for the individual consumer;

⁸⁰ OECD, *Examining Consumer Policy: A Report on Consumer Information Campaigns Concerning Scams* DSTI/CP(2005)12/FINAL (OECD, December 2005).

⁸¹ See BCSC [statement of priorities]; FSA, *Financial Capability in the U.K.: Delivering Change* (London: March 2006).

- employ an authoritative tone;
- tell stories to engage consumers in the issues;
- identify a clear target market, understand the key triggers of that group and focus the messages accordingly; and
- engage strategic partners to increase the reach and extend the length of the campaign.

Research on what makes an effective financial education campaign has been less specific. Very few financial education campaigns are formally evaluated for their effectiveness, and so models of evaluation and indeed of best practice are still in their infancy.⁸² Indeed some financial information and education strategies are almost impossible to evaluate. It is practically impossible to assess whether the goals of a financial education strategy (improvement in a person's financial understanding and changes in their behaviour) have been achieved through a person reading an information leaflet or accessing a website.

More focused and directed education initiatives are easier to assess. Assessment can take two main forms – information retention (testing), and impact on behaviour. As noted above, the OSC tests information retention after its financial seminars. This at least enables it to assess the effectiveness of that particular presenter and that particular course. Assessing whether or not education initiatives have an impact on consumer behaviour is harder. It is most easily conducted in workplace-based financial initiatives, as employers have data on employees' financial behaviour, such as pension contributions, which they can use to assess whether or not workplace financial education initiatives have in fact had an impact on this aspect of a person's financial decisions.⁸³

Although assessments of both financial education and financial information/awareness campaigns are still in their infancy, there are some general conclusions that can be drawn. First, information and education campaigns need to differentiate between their target audiences at least in so far as they recognize different patterns of financial literacy across demographic groups. Secondly, information and education campaigns need to ensure they involve the generalist media, rather than specialist financial outlets. Thirdly, regulators cannot hope to deliver information and education campaigns on their own. They need to key into existing civil society and workplace groups, and they need to engage partners. The FSA's financial and debt healthchecks, for example, have received nearly three times more hits on the BBC website than they have on the FSA's website. Its *moneylaidbare* campaign has been linked to by 175 external sites,

⁸² See B. Smith, *Improving Financial Literacy: Analysis of Issues and Policies* (OECD, November 2005).

⁸³ Ibid.

which as the FSA concludes, enables the material to go to a much wider audience than it could if it relied on the FSA's website alone. This is not surprising. As noted above, 70% of the U.K. public are not aware of the FSA's existence, for example, and of those that are, 50% of them require prompting before they can accurately remember its name. That leaves 15% who can name the FSA as the U.K.'s financial regulator unprompted. In these circumstances, the FSA website, or indeed any regulators' website, is unlikely to be the first place that the majority of consumers will turn for information or advice, as they are simply not aware of its existence. Regulators are increasingly recognizing that they therefore simply cannot rely on investors to come to them; they have to find ways of reaching out and engaging proactively with them. Partnerships are a key way in which this can be achieved.

iii. Summary

Securities regulators in Canada, the U.K. and Australia are thus employing a range of different strategies to inform and educate consumers. In Canada, the Securities Commissions have taken the lead in this area, and have been far more active than the SROs.

Although there is little data on the effectiveness of information and education strategies, such that there is suggests that key elements of success are:

- to key into existing community, education or workplace groups;
- to tailor campaigns to the differences in financial literacy and capability of the particular audiences;
- to make it relevant for consumers – communicating in a language they can understand; getting their attention through direct and 'eye-catching' initiatives or literature;
- to move information and education campaigns out of the specialist financial press and into the general media;
- to work with partners in devising and delivering information and education; and
- to develop a cohesive, coordinated approach to investor education across Canada.

Finally, as the next section discusses, regulators could leverage off their information and education initiatives in a number of ways to expand consultation and participation of retail investors. Information and education activities should thus be seen as an integral part of involving consumers in securities regulation, and a way of determining their interests and needs. A number of recommendations can be made as to how information and education strategies could be enhanced.

iv. Recommendations

Information and Education

Recommendation #2.1: Establish and expand links with strategic partners in developing and delivering information and education to retail investors, including non-financial media and websites. Use the findings of financial capability research to identify the most vulnerable groups.

Recommendation #2.2: Differentiate target groups and ensure the content, presentation and mode of delivery of information and education is appropriate for the relevant group.

Recommendation #2.3: Develop performance measures to assess the impact of information and education initiatives.

Recommendation #2.4: Ensure information and education initiatives are seen within the regulatory organization as an integral part of a strategy of involving consumers in the policy process.

Recommendation #2.5: Use the strategic partnerships developed and the information gained through information and education initiatives to enhance consumer consultation and participation.

7. Consultation and Active Participation by Consumers

This section considers the other two main modes of involvement by retail investors in the regulatory process as means for determining their interests: consultation and active participation. It explores the opportunities offered for formal, public consultations in which all retail investors are free to participate, and opportunities for more focused and active participation by retail investors in the regulatory process either directly or through representative groups that are incorporated into the regulatory structures, such as investor advisory groups and consumer panels.

i. Consultation and Participation

a) Opportunities for Open, Formal Consultation

In Canada, as in the U.K. and Australia, all the securities commissions publish proposed changes to their rules for consultation and comment as well as changes being proposed by the SROs that they have recognized. All regulators are also required to give a general statement of feedback on the responses they receive, though in those responses none differentiate between types of respondent or attribute responses to particular groups, such as retail investors or consumer advocates.

Navigating a way through the consultation and comment papers can be difficult, even for committed retail investors. Documents are usually set out in very legal terms, and their impact and relevance can be hard to gauge. In 2001 the FSA introduced a system of grading its consultation papers in terms of their impact on retail investors: those consultation papers with 3 stars have the greatest impact, those with none the least. Each consultation paper also states clearly the potential impact of the proposals for retail investors. This has helped consumer advocates focus on which proposals are relevant, though in most cases the FSA has already notified them of the initiative and in many cases had prior meetings with them.

Annual reports are a further potential way in which retail investors can be informed, and in some cases consulted. Some regulators outside the securities sector publish their annual reports in draft for consultation, for example, the U.K. telecommunications and broadcasting regulator, Ofcom. None of the Canadian securities regulators publishes its annual report in draft for consultation, however, neither do the FSA or ASIC.

Indeed, some of the SROs have only just begun to produce annual reports in any form: IDA in 2002 and MFDA in 2005. RS has produced one since its formation in 2002.

Some, for example the FSA, also publish their strategic plans or statements of priorities for consultation. The SROs do not publish strategic plans at all; BCSC publishes a statement, but not for consultation. The ASC does not publish one.

Whilst publication of annual reports, statements of priorities, rule changes and so on are important in terms of the transparency and accountability of the regulator, they offer few real opportunities for consumers to be consulted and are rarely effective means of canvassing their views. On occasion consumer advocates might organize a number of people to respond to particular consultation papers, but this is very rare. On the whole regulators reported very low rates of responses by retail investors to their consultation or comment papers, rarely more than two or three. However there was no systematic monitoring or recording of the number of responses received by individuals or retail investors to consultation papers, and feedback statements do not reference comments to any particular group of respondents.

b) Open Meetings

Annual public meetings at which the public are free to speak are common in Australia and the U.K. for all the major regulators, including securities regulators. In contrast, they are not a prominent feature of Canadian securities regulation. The OSC's first Investor Town Hall meeting in May 2005 is a notable exception, although there are as yet no plans for it to be repeated this year. The Investor Town Hall was held by the OSC, and representatives from the IDA, MFDA, OBSI and SIPA (Stan Buell) were invited by the OSC to attend to respond to consumers' views and concerns. Over 400 investors attended the meeting, which was audiocast on the web.

Public meetings such as the Investor Town Hall can provide opportunities for consumers to put their views directly to senior regulators and to ventilate their grievances. They can be an important symbol of openness on the part of a regulator, but they are rarely the place for in-depth engagement. As a result, they can be frustrating for both regulator and consumers.

Consumer groups and regulators involved in the OSC Town Hall meeting, for example, both commented that whilst it made the regulators aware of the level of dissatisfaction consumers had with the regulatory

system, particularly the complaints process, it was in part an unsatisfactory exercise as the regulators could not offer more than general reassurances. In particular regulators commented that the meeting did not raise any new issues, although they were surprised at the difficulties so many were experiencing in getting redress, and somewhat frustrated that so few consumers seemed aware of the redress channels that existed, or the nature and limits of the regulators' remit and their inability to provide investors with restitution.

Nonetheless, consumer advocates were pleased with the meeting as they felt it enabled them to vindicate their claims that many consumers were infuriated by the complexity of the complaints system, the inability of the regulatory system to provide effective mechanisms for redress, the need for more consultation with retail investors by the regulators. The meeting also raised awareness of the impact of the reduction in limitation periods on which two advocacy groups in particular, SIPA and CARP, had been campaigning. Although the latter is not a matter within the securities regulators' remit, consumer advocates are hoping to use the regulators to lobby the provincial governments and to gain exemptions for securities-related claims.⁸⁴

The impact of the Town Hall meeting on regulators has varied considerably between the different regulators. That it has had the biggest impact on the OSC is not surprising. The OSC initiated the meeting after the 2004 Senate committee hearings raised the issue of the place of retail investors in securities regulation,⁸⁵ and after active campaigning by consumer advocates - SIPA in particular - for such a meeting. The Town Hall meeting raised the need for better engagement with regulators further up the regulatory agenda. It prompted the formation of the Investor Advisory Committee,⁸⁶ and made better engagement with retail investors one of the OSC's strategic priorities for 2005-6.⁸⁷

For the IDA, although it was felt that most of the Town Hall complaints did not relate to IDA firms, the Town Hall meeting moved the issue of brokers' complaints resolution processes far higher up the agenda than it had been before. The IDA is therefore now focusing on the effectiveness of firms' complaints resolution processes, and whether these processes are prejudicing client's access to other remedies. It is looking to put in place standards that mean that firms' complaints processes are not prejudicing consumers from pursuing civil suits within the new, reduced, limitation periods introduced by several provincial governments, including Ontario.

⁸⁴ In Ontario they have been successful in so far as taking the case to the Ombudsman 'stops the clock' on the expiration of the limitation period.

⁸⁵ See D. Brown, *Remarks to the Standing Senate Committee on Banking, Trade and Commerce*, Ottawa, June 16 2005, available from the OSC website.

⁸⁶ See http://www.osc.gov.on.ca/About/NewsReleases/2005/nr_20051004_osc-investor-advisory.jsp.

⁸⁷ http://www.osc.gov.on.ca/About/WhatWeDo/wwd_2006-2007_statement_of_priorities_final.jsp.

For RS, the meeting was less relevant as none of the complaints involved a violation of the Universal Market Integrity Rules – the trading rules that RS administers and enforces for the marketplaces it regulates. Nonetheless, they too received the message that consumers need better information and easier access to systems of redress. In response, part of its website redesign will include better signposting and links for where consumers can go to get redress.

Finally, for the MFDA, the impact has been mixed. The meeting has been used by the enforcement division to highlight to their staff the severe impacts that financial loss can have on individuals’ health and personal well-being, and thus the seriousness of the breaches that occur. At the time of the Town Hall meeting the MFDA had been developing new procedures to review complaint handling by members and to help investors navigate the complaints processes and understand their options for pursuing redress. The Town Hall meeting reinforced the MFDA’s commitment to these changes, but did not prompt any new policy initiatives.

The table below compares the different opportunities for open consultation offered by the securities regulators.

Figure 4: Opportunities for open consultations offered by different regulators

Regulator	OSC	BCSC	ASC	IDA	MFDA	RS	FSA
Opportunity for consultation							
Annual reports published	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Annual report for consultation	No	No	No	No	No	No	No
Strategic priorities published	Yes	Yes	No	No	No	No	Yes
Strategic priorities for consultation	No	No	No	No	No	No	Yes
Proposed rules published	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Relevance for consumers highlighted	No	No	No	No	No	No	Yes
Feedback on responses to consultation	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Public meetings	Yes (one Town Hall)	No	No	Yes (one Town Hall)	Yes (one Town Hall)	Yes (one Town Hall)	Yes, annual

ii. Opportunities for More Active Engagement: The Role of Research

As noted above, some Canadian securities regulators have also begun to engage in more proactive ways of understanding investors' views and needs, and obtaining the views of consumers on aspects of regulatory policy. In particular, deliberative research methods, including the 'piloting' of policy proposals on investors, can be a form of consultation. Thus focus groups, surveys, web-based interactive processes and other research techniques can both provide regulators with information on consumers' skills and behaviour, and, depending in part on how they are structured, provide consumers with an opportunity to respond to policy initiatives being proposed by the regulator and in some cases propose alternatives.

These alternative modes of engagement can be very fruitful, as discussed in Section 5. However, they are expensive. There has been some collaboration of research and consultation efforts between the securities regulators via the CSA, which can help pool costs and avoid duplication, clearly particularly important where a national measure is being considered. These should be extended where possible.

Regulators may also be able to leverage off their renewed education and information initiatives, as discussed in Section 5. By tapping into different groups of consumers, in further education, in the workplace, in community groups and so on, some regulators are hoping to get access to consumers that they can then use in their policy development.⁸⁸ These potentials for feedback loops and interactions reinforce the links between knowledge and involvement illustrated above (Figure 3, Section 4.).

Whilst these initiatives can be a positive way of engaging more directly with consumers, research tends not to be treated as a consultation exercise by Canadian securities regulators in that it is often unpublished. This obviously makes it hard to access. This has two implications: it makes it hard for other consumer representatives, advocates or indeed other regulators, to learn from, and it makes it difficult to assess whether the proposed regulatory initiative is in fact supported by the research conducted. In contrast the FSA publishes the results of all consumer research commissioned,⁸⁹ as does its Consumer Panel. ASIC also publishes its research papers, as does its Consumer Advisory Panel⁹⁰

⁸⁸ Interview, BCSC officials, 07/04/06.

⁸⁹ Available at [FSA REF]

⁹⁰ <http://www.fido.asic.gov.au/fido/fido.nsf/print/ASIC's+Consumer+Advisory+Panel?opendocument> and http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/Home+Page?openDocument.

iii. Participation

Participation is a more direct and active form of involvement by retail investors in policy making processes: defining the issues, setting the agenda, and shaping the policy debate, although the final decision rests with the regulator. As noted in Section 3, there is a range of different ways of securing participation, relatively few countries or regulatory regimes explored them extensively. These include:

- participation by consumer representatives in consumer panels, committees or other forums that advise or comment on regulators work;
- consumer or multi-stakeholder workshops / negotiations;
- citizens' juries;
- consensus conferences; and
- web-based 'reference groups'.

In securities regulation to date in Canada, the U.K. and Australia, the main mode of participation that has been employed or recently introduced is participation through the appointment of consumer representatives to consumer panels, committees or other advisory groups. It is worth noting that in the EU, the European Commission is also currently creating a specialist consumer advisory panel for financial services.

iv. Participation: The Role of Consumer Representatives on Investor Advisory Groups and Consumer Panels

Consumer representatives refer to those individuals and organizations who are formally included in the institutional structures of securities regulation as representatives of retail investors. They are thus distinct from consumer advocates.⁹¹ In the regulators considered, there are three main types of consumer representative:

- individuals who sit as representatives of retail investors on advisory committees that are otherwise dominantly comprised of industry representatives ('lone voices');
- advisory committees comprised predominantly of those who sit as representatives of retail investors, with a general mandate to represent retail investors; and

⁹¹ Though particular individuals may be both consumer advocates and consumer representatives.

- independent consumer panels that have a statutory mandate to represent consumer interests, with a separate budget and independent reporting systems.

Opportunities for more active engagement through consumer panels or other representative bodies are very limited in Canadian securities regulation. In the U.K. and Australia, independent specialist Consumer Panels exist whose mandate it is to be consulted and comment on the securities regulators' rules, policies and practices. Similar panels exist in the U.K. for regulators in the energy, postal services and broadcasting and telecommunication sectors.⁹² The organizational structure of these panels is currently under review in the U.K., but the government has emphasised the need for maintaining a specialist consumer body in financial services.⁹³ In Australia, the Consumer Advisory Panel advises ASIC on consumer protection issues and on its policy proposals and regulatory activities.

There is no equivalent in Canadian securities regulation or indeed Canadian financial regulation more broadly. Indeed there are only securities two regulators that have any formal consumer representatives (as opposed to public interest Board members): RS and the OSC.

Figure 5, below, sets out some of the key differences between the different structures of consumer representation.

⁹² These are energywatch, Postcomm and the Ofcom Consumer Panel, respectively.

⁹³ DTI, *Strengthen and Streamline Consumer Advocacy* (London, 2006).

Figure 5: Comparing Organizational Structures of Consumer Representation

Organization	Date established	Status	Method of selection	Payment for members	Own Budget	Reports published	Relationship with regulator
RS's Rules Advisory Committee – single representative	Dec 2005	Invited guest	Invitation	No	No	No	Advisory, 6 meetings per year
OSC's Investor Advisory Committee	Dec 2005	Advisory committee	Open competition, selection by OSC	No	No	No	Advisory; 4-5 meetings per year
Financial Services Consumer Panel	1998	FSA under a statutory obligation to form the Panel since 2000	Open competition, selection by public interest members of FSA Board	Yes; payment varies with time commitment given: up to £15,750 for 45 days per year; chair received £35,000 (2005 figures)	Yes (Can £440k in 2005)	Yes	'Critical friend'; frequent meetings between FSA staff and Panel members and FSA and Panel chairs; monthly meetings of Panel members and further monthly meetings of committees; FSCP publishes detailed comments and assessments; FSA obliged to respond in its annual report
ASIC Consumer Advisory Panel	1998	Established by statute	Selection by ASIC board	No – majority of members are consumer advocacy organizations	Yes	Yes	Four meetings of Panel in 2004-5; summary information only published on issues discussed with ASIC in ASIC Annual Reports.

a) Market Regulation Services Inc (RS)

RS has opted for the ‘lone voice’ model, and appointed Professor Lawrence Kryzanowski to act as a representative of retail investors on its influential Rules Advisory Committee (RAC). RAC is otherwise made up of representatives of marketplaces, dealers, institutional investors and members of the legal and compliance community. RAC is RS’s key policy advisory committee. It advises RS staff on their proposals before they go to the Board, and whilst it is possible for something to go up that RAC has not approved, this is not a frequent occurrence. RS sets the agenda of the committee, on the whole, although it is open for committee members to ask for items to be added.

Professor Kryzanowski does not have a formal seat on the committee; instead he attends as a guest, though with full speaking rights. RAC operates on a consensus basis rather than by voting on issues, so the question of voting rights has not arisen. Professor Kryzanowski is a well-respected specialist in finance at Concordia University. He was first invited in December 2005, and since January 2006 has been attending RAC’s bi-monthly meetings.

b) OSC’s Investor Advisory Committee

The OSC has adopted the advisory committee model. The OSC has over 15 advisory committees already, all composed of industry representatives. The Investor Advisory Committee, formed in December 2005, is distinguished from these committees by its membership: it is comprised entirely of investor representatives. It is an experiment that is being keenly watched by some of the other Securities Commissions. The IAC was formed after a process of head hunting and an open application process. Over 140 applications were received, and a committee of the OSC board and staff selected 10 members. The IAC is chaired by Professor Eric Kirzner of the University of Toronto, again a distinguished professor of finance, who had previously chaired the Toronto Stock Exchange’s investor advisory committee.

The OSC and members of the committee are quite clear that the committee is there as an advisory committee to the OSC. It is set up to advise the OSC, not to have an independent ‘life of its own’. The members are also clear on their role. As one commented:

‘We’re not a stand-alone body, but an advisory committee. So we have to be reactive to what the OSC thinks is important, but at the same time we polled members on issues that they think are important

and we will follow those up – so there's a balance between being proactive and reactive.... We're partly a focus group responding to issues and partly an active advisory group.'

The members are independent from the OSC, however, and are not paid. The IAC will meet four to five times a year, and again the meetings are not long, around half a day. To date it has had only two meetings, and the third is scheduled for July 2006. It is therefore in its very early stages, and too soon to come to any conclusions about the nature of its role.

Thus far, the IAC has set its own agenda, although it has let it be known to OSC staff that it wants staff to approach the committee if they have key issues they want to discuss. Each member has been given the opportunity to say what issues they would like the committee to explore, and so far it has focused on the initial meetings between investor and advisor and the complaints process; the latter will be considered in more depth in its next meeting. The chair of the committee is keen to establish an open dialogue with the other regulators, and the IDA and the MFDA have already made presentations to the committee.

The committee has no separate budget to fund research projects, and although assurances have been given that the IAC does have limited access to research capability from OSC staff. Whether it would be given the resources to conduct large scale, independent empirical research on investor behaviour or experiences, for example, or the impact of particular policies, is not an issue that has yet arisen. At present it does not have a dedicated researcher, although it has one full-time staff member assisting it. The OSC is committing considerable resources to the IAC in terms of senior officials' time, however. The chair of the IAC meets with the Chair and other senior officials both before and after each IAC meeting, and the vice Chair and Deputy Director of the OSC have both attended its meetings. Minutes of the IAC meetings are circulated amongst senior Board and executive officials, including the head of market policy.

The issue of whether the committee will publish a report on its activities is still an open question. The sense is that the IAC is an experiment that is still in its early days. Those spoken to on both the IAC and the OSC are waiting to see how it will evolve, and what direction it will go. There is a clear recognition that having established it, the OSC will have to follow its advice, but it is anxious not to develop an adversarial relationship with it. There is a fear that publication of points of disagreement could upset a delicate relationship that is still in its infancy. Similarly, the issue of how the IAC's impact may be evaluated remains an open question. Nonetheless, the OSC has committed in its Statement of Priorities for fiscal year 2006 to

survey the chair and members of the IAC in order to improve the IAC's recommendations and make improvements for the future.⁹⁴

c) ASIC Consumer Advisory Panel

The Panel was established in 1998 to advise ASIC on consumer protection issues and provide feedback on ASIC policies and regulatory activities. It is funded by ASIC. The majority of members are consumer organizations, including the Australian Consumers Association, the Australian Shareholders Association and the Australian Investors' Association.⁹⁵

In 2004-5, the Panel met four times. It can formulate its own agenda, and responds to ASIC policy initiatives. It does not issue a separate annual report, however. Rather it issues a short summary of its activities in the main ASIC annual reports.⁹⁶ Nonetheless, it does commission its own research. In 2004-5, three projects were funded into consumer behaviour with respect to specific investments (self-managed super funds and re-financing of household debt) and a joint consumer response to an ASIC and ACCC paper on debt collection.⁹⁷ Other projects that it has worked on include a review of consumer education initiatives; the publication of a Financial Services Network Directory to facilitate consumer consultation; translation of consumer materials into a range of languages for different ethnic groups; and research reports into consumer education and consumer decision making at retirement.⁹⁸

d) Financial Services Consumer Panel

Structure and Remit

The FSCP was established as an advisory committee in 1998, and was put on a statutory basis in 2000.⁹⁹ The FSA is also statutorily obliged to establish a panel for practitioners: the Practitioner Panel. It has also established the Small Businesses Practitioner Panel for small business representatives.¹⁰⁰

⁹⁴ Statement of Priorities for fiscal year 2006.

⁹⁵ The other members are: Victorian Consumer Credit Legal Service; the National Centre on Retirement Investments; the Financial Services Consumer Policy Centre; the Queensland Centre for Credit and Consumer Law, and two individual members. It is chaired by Fiona Guthrie, the Deputy Chair of the Consumers Federation of Australia. See <http://www.asic.gov.au/fido/fido.nsf/byheadline/ASIC%27s+Consumer+Advisory+Panel?opendocument>.

⁹⁶ See e.g. ASIC Annual Report 2004-5, p.25.

⁹⁷ Ibid.

⁹⁸ See <http://www.asic.gov.au/fido/fido.nsf/byheadline/ASIC%27s+Consumer+Advisory+Panel?opendocument>

⁹⁹ Financial Services and Markets Act 2000, s.8-10.

¹⁰⁰ See <http://www.fs-pp.org.uk> and <http://www.sbpp.org.uk/index.htm>.

The Consumer Panel is funded by the FSA, and is supported by three full-time FSA staff members. It also employs its own public relations manager on a part time basis. It has 15 members who are selected after an open application process and who sit for a maximum of six years.

Its terms of reference state quite clearly that the Panel is to be an independent body that is to represent the interests of consumers and provide advice to the FSA. It has no role in investor education, and plays no role in handling complaints. Complaints are dealt with by the Financial Services Ombudsman Service.¹⁰¹ The Panel's terms of reference are set out in Appendix 1.

The Panel is given a separate budget by the FSA. In 2005 this was £440,000 (\$900,000) of which the Panel spent just over £400,000 (\$800,000). The Panel pays its members on a sliding scale depending on their level of time commitment. Members receive up to £15,750 (\$32,175) for 45 days per year, and the chair receives £35,000 (\$71,000). The Panel has a separate budget for research, which in 2005 was £115,000 (\$235,000).

It is worth noting that the Practitioner Panel and the Small Business Panel, in contrast, are selected by industry representatives and funded by the industry. The reason for the difference is that when it was established, the FSA recognized that consumer representatives were likely to come from organizations that could not afford to fund their work for the Panel, or provide them with the resources necessary to do their job effectively.

Although the Panel is selected, funded and indeed in the same building as the FSA, both the FSA and the Panel are quite clear that it is an independent body. The FSA is required to consider representations made to it by either Panel, and should it disagree with the statements, to give the Panel a written statement of its reasons for disagreeing. The Panel publishes annual reports, and the FSA's own annual report includes a statement from the chairmen of the Panel. The Panel further comments on the comments the FSA has given, and reports on actions the FSA has or has not taken to fulfil commitments it has made.

Relationship with the FSA

Establishing the Panel was a risk; it was a novel body with a novel role. And, as one participant at the time commented: 'Once you have a consumer panel, it's hard to scrap it'.

¹⁰¹ It is worth noting that the recent DTI / HMT review of these consumer panels concluded that combining the functions of consumer representation and dispute resolution had not been a success, and is proposing to create separate ombudsmen for these sectors: DTI / HMT Report.

Being independent does not mean being confrontational, however. The Panel's role was described by the FSA's first chairman as that of a 'critical friend'. The Panel is open in criticising the FSA where it differs from it, but its annual reports contain a balance of praise as well as criticism, and the working relationship is on the whole a cordial one. Each work on the basis of 'no surprises': advance notice is given by each prior to any public announcements being made, and as discussed below there are frequent meetings between Panel members and FSA staff.

Who sets the agenda of a consumer representative body is clearly important in understanding its relationship with the regulator. The Panel has on the whole been reactive to the FSA, responding to FSA initiatives rather than initiating its own. This is in part because the pace of change in U.K. financial services regulation has been so great since 1998. When it was first established, the Panel tried to respond to every consultation paper that affected retail investors, including prudential matters. However, the rate of change in financial services regulation was such that it was simply impossible to keep up (the FSA issued 209 consultation papers in its first six years (1997-2003), in addition to policy statements, discussion papers and feedback statements. In contrast, it has issued only 37 consultation papers since 2004). The Panel therefore soon moved to focusing only on those that had a significant impact for retail investors. As the pace of change has slowed slightly, it has had more opportunity to develop its own agenda.¹⁰² However the issues that it is focusing on are also key issues for the FSA, including changes being introduced at the EU level, the FSA's 'treating customers fairly' initiative, and improving FSA communications with investors.¹⁰³

The FSCP has been active in commissioning its own research. Since its inception in 1998, it has commissioned 16 research reports on consumer issues, and commissioned a further four pieces of research into more specific issues. Its consumer research has focused on issues including consumers' money management and financial planning; consumer confidence in the financial industry; how people buy; understanding consumers needs; and the place of consumers in the financial market place. This research plays a valuable role in formulating the Panel's activities and its communications with the FSA. FSA officials further comment that they take the Panel's comments particularly seriously when they are supported by research findings.

¹⁰² Its statement for priorities in 2005 include more general objectives, such as 'putting the service back into financial services' and 'evaluating the effectiveness of the FSA' to more specific objectives relating to substantive policy issues: FSCP, Annual Report 2004-5 (London: 2005).

¹⁰³ FSCP Annual Report 2004-5, chapter 3.

The time commitment of Panel members can also be an indicator of the depth and substance of its work. The FSCP meets monthly, and there are further monthly meetings of its working committees. It has regular meetings with FSA staff with respect to each policy initiative, latterly those that impact most on retail investors, and the chairs of the Panel and the FSA meet regularly. On any one initiative, meetings are held in the pre-consultation paper phase, then again to discuss responses to the consultation papers by the Panel and others, and then again in the stage prior to the final decision. Meetings at this level are generally between Panel members and those FSA staff engaged in doing the project work. In addition, there are annual meetings between the Panel and the FSA Board. These supplement the Panel's formal, published responses to the FSA's consultations.

The FSA staff also have regular meetings with the Panel to inform them what is going on, and Panel members can ask for meetings whenever they have issues that concern them. These are in addition to the meetings on specific policy proposals. The FSA has also recently begun to give management information to the FSCP, for which they had asked for some time. This includes data on consumer inquiries to the contact centre, data on web site users and profiles of risk on particular products. This information is valuable as it enables the Panel to understand the FSA's view of what is happening in the market, and to track trends in consumer concerns and behaviour. It can thus better understand and evaluate what the FSA is doing, and make proposals of its own.

Panel members thus work at a very detailed level and engage closely with policy issues. Location of the Panel in the same building as the FSA is regarded by members of both the FSA and the Panel as helping them in this respect, and generally in facilitating communication between them. One Panel member commented:

‘Geography is an important feature of the Panel. We’re located in the FSA’s offices. If we were somewhere else in central London we just wouldn’t have the contact that we have; we just wouldn’t have the same frequency of meetings, the same involvement. That’s important.’

It is worth noting that the U.K. Department of Trade and Industry and the Treasury have recently made several recommendations for how consumer panels, including the FSCP, should operate.¹⁰⁴ These include:¹⁰⁵

¹⁰⁴ Other consumer panels in the U.K. are: the Ofcom Consumer Panel; energywatch and Postwatch. Postwatch and energywatch are also the dispute resolution bodies for the energy and postal sectors respectively. It is worth noting that the recent DTI / HMT review of these consumer panels concluded that combining the functions of consumer representation and dispute resolution had not been a success, and is proposing to create separate ombudsmen for these sectors: DTI / HMT Report.

¹⁰⁵ DTI / HMT report 2004, paragraph 5.11.

- developing and publishing clear criteria by which they will prioritize activities;
- conducting rigorous research into those issues that currently have the greatest impact on consumer welfare and are likely to do so in the future and using this in formulating strategies and priorities;
- developing clear and complete forward work programs in consultation with their main stakeholders;
- applying rigorous project and program management techniques to all campaigns and activities and developing excellence in this area, possibly through joint training; and
- focusing on the outcomes for consumers of their actions, and the most effective means of securing those outcomes.

The U.K. National Consumers Council has made similar recommendations.¹⁰⁶

Assessing the Panel's Impact

The relationship between the FSA and the FSCP is viewed by both sides as a profitable one. Indeed, in the current consultation on the role of consumer panels in the U.K., the FSA has written to the Government expressing its strong support for the FSCP as it is currently constituted.

There are a number of instances where the FSA has changed its policy to be in line with the Panel's recommendations, but whether or not the Panel was the sole cause of that shift is necessarily hard for anyone, including the Panel, to assess. Nevertheless, one senior FSA official commented that having the Panel had meant that FSA staff concerned with retail investor policy did try to anticipate the Panel's reactions to policies under consideration, and shape their arguments, if not always their policies, accordingly. This type of 'pre-emptive' impact is obviously hard to measure, but can act as a significant shaping influence on policy development.

Moreover, the Panel can be useful for the regulator in that it provides a potentially powerful voice against the industry, and against particular consumer advocates. One senior FSA official commented:

'It [the Panel] provided a useful filtering mechanism. So if the Consumers Association for example were going on about something, saying it was outrageous and so on, we could say, 'well, the Panel are in favour of it. No doubt if you can persuade them of your view we will obviously then consider it....'

¹⁰⁶ NCC, *Involving Consumers*.

The Panel can thus help to overcome the problem of how to assess whether the concerns of a particular consumer group are widespread and well-founded, or just ‘axe-grinding’ on behalf of a small group.

Making more formal assessments on how far the Panel has made an impact on the FSA is difficult. The U.K. Department of Trade and Industry and the Treasury have recently recommended that consumer panels should assess the impact of their activities and should develop meaningful measures of performance that assess:

- their operational effectiveness over time;
- the outcomes of specific campaigns or initiatives: individual project quality, impact and degree of influence exerted; and
- aggregate measures of impact and reputation.¹⁰⁷

The Panel has so far adopted a fairly piecemeal approach to evaluating the FSA and the Panel’s impact on it. Annual reports have tended to evaluate policies on a one by one basis, almost in chronological order, making it hard sometimes to get an overall assessment. The Panel is currently exploring ways of developing a more holistic evaluation, and will publish these in 2006-7.¹⁰⁸ It is not alone in these attempts. In 2005, the Ofcom Consumer Panel commissioned consultants to devise an audit methodology to evaluate the extent to which Ofcom, the U.K.’s telecommunications and broadcasting regulator, pursues the consumer interest in its regulatory activities. It will be adopting this model in 2006.

v. How Representative Are Consumer Representatives?

Consumer representatives, like consumer advocates and regulators themselves, face the issue of how representative are they of consumers. The FSCP tries to address this problem through commissioning independent research, as noted above. Indeed in its recent review of consumer panels, the U.K. government stated that a key element of their effectiveness was their ability to conduct independent research.¹⁰⁹

The Canadian consumer representatives on the RS or the IAC do not have independent budgets for this purpose. Those interviewed varied as to whether or not they felt they were personally representative of consumers, but all felt that there were inevitably significant gaps in their knowledge about consumers needs,

¹⁰⁷ DTI / HMT: *Consumer Voice*.

¹⁰⁸ It commissioned preliminary research on this issue in 2001: FSCP, *Assessing the FSA’s Effectiveness* (London, 2001).

¹⁰⁹ DTI / HMT, *Consumer Voice*.

and many felt concern that they did not have the resources or facilities to fill those gaps. Most relied heavily on ‘life knowledge’. For example, one commented:

‘Life knowledge is an important part of my role, because the issues I’m looking at are a very technical set of issues. Also I read the papers, I talk to retail investors.’

Q: ‘Who do you talk to?’

A: ‘Well, it’s hit and miss really; there’s no good way of doing it. I’ve thought about this a lot; I’ve thought about having a website, but then I’d get bombarded by issues / complaints where in fact the person just had a poor investment, or didn’t understand the risk / return ratio properly.’

There is a real sense amongst those Canadian consumer representatives spoken to that they face a significant challenge in communicating directly with consumers and are unsure how to meet it. One member of the IAC commented,

‘This is meant to be an interface between investors and regulators, but how is this meant to work? How is the communication of the IAC with a wider body of investors going to happen?’

It is striking that all Canadian consumer representatives spoken to called for access to more collaborative and independent research on consumers’ skills, behaviour, experiences and needs. Without meaningful ways of understanding the needs and experiences of investors, consumer representatives are going to fall prey to the same criticism faced by consumer advocates: that all they represent is themselves.

vi. Summary

Ensuring active consultation and participation by consumers in regulatory processes is difficult, and requires regulators to move beyond the traditional, paper-based comment processes. The main methods of consultation used by Canadian, U.K. and Australian securities regulators to date are public meetings, and more focused consultations with groups of investors through focus group research.

With respect to participation, the most significant recent development in Canada has been the creation of the OSC Investor Advisory Committee. This has the potential to allow direct consumer representation and participation in policy making. The IAC is distinct from consumer representative panels in Australia and the U.K., and is still in its infancy.

There are alternative forms of active consultation that have not been used in securities regulation but that have been used in other regulatory areas, such as citizen's juries and other deliberative panels. Further, investment education initiatives may provide background support for which regulators could use to develop active consultation with consumers on specific policy proposals that have not yet been fully exploited.

In short, there is still considerable scope for Canadian securities regulators to improve and expand the practices for consulting retail investors and facilitating their participation.

vii. Recommendations

Consultation and Participation

Recommendation #3.1: Use plain language in all consultation papers and make their relevance for retail investors clear from the outset. Allow equal access to timely and relevant information that is easily understandable.

Recommendation #3.2: Systematically monitor the responses to consultations received from individuals and retail investors and give specific feedback on their responses.

Recommendation #3.3: Publish the results of all consultation processes including responses received to consultation papers, unless the respondent specifically indicates it does not want the response published.

Recommendation #3.4: Expand the range of consultative methods used to ensure involvement of as wide a range of groups and individuals as possible.

Recommendation #3.5: Engage in more direct participatory methods including multi-stakeholder workshops, in which representatives of industry and retail investors can discuss policy options.

Recommendation #3.6: Expand the role of consumer representatives in all securities regulators, including the CSA, through the establishment of investor advisory committees, consumer panels or similar bodies.

Recommendation #3.7: Ensure all investor advisory committees / consumer panels have a clear remit, are adequately remunerated, have an independent budget to allow them to commission research; have

timely access to all relevant information, including research conducted by the regulator or others, and are given the necessary training to enable them to be effective.

Recommendation #3.8: Consumer representatives should publish a summary of their activities on an annual basis, including their criteria by which their priorities are established.

Recommendation #3.9: Consumer representatives should develop methods of collaboration with representatives in other securities regulators, nationally and internationally, wherever possible.

Recommendation #3.10: Regulators should develop programs to enhance the civic capacity of retail investors and consumer representatives to enable them to be effective participants in the regulatory process.

Recommendation #3.11: Regulators and consumer representatives should develop methods for assessing the impact and effectiveness of different consultation and participation methods, including the activities of investor advisory committees or consumer panels.

8. Making a Difference? The Role of Consumer Advocates

Consumer advocates have the potential to be an important part of the solution to the problems regulators have in communicating with investors, and there are some very active consumer advocates both in Canada and the U.K..

This section focuses on the key consumer advocates in securities regulation in Canada and the U.K.. It examines the criteria that some groups use to identify which issues to campaign on, the ways in which consumer advocates communicate with regulators, methods that are or could be used by consumer advocates to evaluate their impact, and the issue of how representative they are. Finally, it considers proposals that have been put forward for an independent consumer organization for financial services in Canada.

i. Key Consumer Advocates in Securities Regulation

There is no coherent, national consumer ‘voice’ in securities regulation in Canada. Instead, a far greater role is played by individual consumer advocates and by two investor advocacy groups: SIPA (the Small Investor Protection Agency) and CARP (Canadian Association for the Fifty Plus). SIPA is a specialist investor advocacy organization founded and run by Stan Buell. It is a small organization, founded in 1998, with around 200 members. CARP is an Ontario-based generalist consumer advocate for the over-50s that has developed a special interest in securities. Their recent campaigns have focused on mutual funds, on the basis that it was the product bought by most seniors in Ontario, and on the reduction in limitation periods for bringing actions recently introduced by many of the provinces. SIPA and CARP have worked jointly on these initiatives.

There is also a host of high profile individual consumer advocates. These individuals tend to focus on one or two issues, are often called upon to give evidence to the provincial securities governments, and are often well-known to the regulators. Prominent individuals include Ken Kivenko, a consultant and advisor to SIPA, who also runs a business, Kenmar, helping people to make claims against financial advisors and brokers. Pamela Reeve, who focuses on the complaints process and firms’ systems of internal client review, is now a member of the IAC. She has also given evidence in 2005 to the Standing Senate Committee on Banking, Trade and Commerce and the Federal Department of Finance on the issue.¹¹⁰ John Hollander, who is also a member of the IAC, has made submissions to the Ontario legislature standing committee on the issue of training and

¹¹⁰ P. Reeve, Submission to the OSC on the Fair Dealing Model, 2004; submissions to the Department of Finance regarding Annex 6 of the 2005 Budget Plan, ‘An Effective and Efficient Legislative Framework for the Canadian Financial Services Sector’.

competence of financial advisors and dealers.¹¹¹ Other prominent individuals who actively campaign include David Yudelman,¹¹² Patricia Cosgrove, Diane Urquhart, Gloria Hutton¹¹³ and Glorianne Stromberg¹¹⁴ and Purdy Crawford.¹¹⁵

However relationships between consumer advocates and regulators can be fraught. For example, one prominent advocate is Robert Kyle, who runs a website, www.investorvoice.ca, which focuses on the IDA and the MFDA. Kyle brought an action before the Privacy Commissioner in 2004 to order the OSC to publish a report on the IDA, completed in 2000. The Commissioner ordered the publication of the report in 2004.¹¹⁶ After commencing an action in judicial review of the decision, the OSC decided to drop its legal action and the report was published in 2005.¹¹⁷ However, Kyle has himself been disciplined by the IDA, with his firm Derivatives Inc., on the grounds of refusing to cooperate in an IDA enforcement investigation,¹¹⁸ and Kyle's appeals to the OSC and the Ontario Superior Court of Justice challenging the legality of the IDA's actions in this regard have both failed.

Aside from SIPA, CARP and a host of individuals, there is really no consumer representation in securities issues across Canada. The main national consumer organizations in Canada have not been particularly prominent in the area of securities regulation in recent years. The Consumer Council of Canada has not campaigned actively in this area recently, and securities regulation falls outside the remit of the FCAC.

The two main consumer advocacy groups that are active, CARP and SIPA, are on the whole poorly funded and operate with few staff. They do not have the resources to engage in substantial research with which to support their claims. Instead they rely on complex networks of contacts developed through their membership, websites, informal links to financial journalists, people working in the industry or staff in the regulatory

¹¹¹ See http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/pdfF025.pdf.

¹¹² See e.g. D. Yudelman, *The Scorpion and the Frog: A Consumers View of Financial Services and how to transform them* (2001), a report for the federal government based on research conducted into consumer views on Canadian financial services, available at www.consumerscouncil.com.

¹¹³ See e.g. evidence to the Ontario Standing Committee on Finance and Economic Affairs, Thursday 19th August 2004.

¹¹⁴ A former OSC commissioner who has written influential reports on reform of the mutual fund industry (*Regulatory Strategies for the Mid-90s: Recommendations for Regulating Investment Funds in Canada* (1995) and *Investment Funds in Canada and Consumer Protection: Strategies for the Millennium* (1998)). She advocates for increased transparency, disclosure and industry reform at the Investor Learning Centre of Canada and also works with SIPA.

¹¹⁵ Chair of the Crawford Panel, *A Blueprint for a New Model: A Discussion by the Crawford Panel on a Single Canadian Securities Regulator* (December 2005).

¹¹⁶ Decision –ref.

¹¹⁷ *OSC Examination of the Corporate Governance and Organizational Structure of the Investment Dealers' Association of Canada and Review of the 1999 Member Self-Assessment* (OSC, 2000), available on the OSC website at www.investorvoice.ca.

¹¹⁸ [1999] IDACD No 29.

offices. CARP and SIPA have produced a report on the mutual fund industry, but they do not have the resources to produce sustained research and comment on all the major issues facing retail investors.¹¹⁹

In the U.K., Which? (formerly the Consumers' Association), is a prominent advocacy group that campaigns in this area.¹²⁰ This is a large, well-established consumer advocacy group, founded in 1957. It is funded through its membership of over 700,000 who subscribe to its consumer magazines and regular surveys of consumer goods ranging from vacuum cleaners to holidays.¹²¹ It has also been campaigning on securities-related products, including life insurance, for many years, and has five full-time people working on research and campaigning on these issues, with a further four working on the financial pages of its magazines. Other groups include the National Consumer Council, which focuses more on financial exclusion, and the National Federation of Consumer Groups, which provides a national framework for local consumer groups.

These three organizations have a formal set of organizational criteria used to determine which consumer issues they should campaign on. These are: access, choice, fairness, information, safety, redress, and representation.¹²² When considering which issues to campaign on, Which? does a detriment analysis to assess how many people are being affected and the amount of money at issue. Which? tends to focus more on issues that affect a large number of people, albeit that in each case only a relatively small sum of money may be at stake, as opposed to something that affects a small number of people, even though the amounts may be large. So it has campaigned hard with respect to endowment mortgages in the U.K., which it estimates affected 5 million people, rather than on the mis-selling of split capital trusts, which affected far fewer people, though in some cases the amounts lost were greater.

ii. Communicating with Regulators

Consumer advocates use a wide range of methods to try to get their messages across. As one commented:

‘How do we communicate with them [the regulator]? Any way we can. Letters, emails, phone calls, meetings.’

¹¹⁹ CARP and SIPA, *Giving Small Investors a Fair Chance: Reforming the Mutual Fund Industry* (September 2004).

¹²⁰ The other main national consumer group is the National Consumer Council, funded by the government. This tends to focus on lower income consumers of financial services, and so campaigns on issues relating to financial exclusion and consumer debt.

¹²¹ See www.which.co.U.K.

¹²² See also NCC, *Involving Consumers*, p. 19.

In Canada, both regulators and consumer advocates report that in the last year they have started to have more formal meetings to discuss issues. As one commented:

‘We’re being made fully aware of their concerns – if possible, we have too much information from these processes – there’s no shortage of information on what the concerns are.’

However, whilst the OSC, ASC and BCSC report more frequent meetings with advocacy groups, those groups are hard pressed to campaign effectively across the whole of Canada. The fragmentation of regulatory responsibilities does not help. Consumer advocates have 13 different securities regulators to deal with. Of the two main organizations, SIPA and CARP, only CARP has a national presence. It has two directors, two assistants, an intern and a part timer to field against 13 regulators plus the provincial and federal governments on securities-related issues. As one consumer advocate commented:

‘The Canadian system is very decentralised, and getting more so – it makes advocacy very complicated. We’ve got to know the right people to go to in all the different bodies. We do our best, but it’s difficult.’

Assessing the impact of its activities is difficult for a consumer advocacy group, as it is for a regulator. Nonetheless, Which? has been developing a performance assessment framework, in which it sets clear targets and objectives for each of its campaigns. So with respect to its campaign on endowment mortgages it set a target of how many people it wanted to complain in a year, which in fact was exceeded.¹²³ But as one consumer advocate commented: ‘we can measure outcomes, but it’s very hard to measure impacts, and impacts might be a long time coming.’

Although they do not have formal assessment processes, Canadian consumer advocates have on the whole been very effective at making their views known to the relevant regulators, and on occasion shaping regulatory behaviour. For example, one event that is largely attributed to sustained activism by SIPA, is the OSC Town Hall meeting. Overall, as one consumer representative commented:

‘There is no separate retail investor voice in Canada. But we do have very vocal individual advocates who have very loud voices.’

¹²³ It focused on complaints rather than redress as it was impossible to say at that stage whether investors had lost, and if so in what amounts.

Whilst they may be making their voices heard, advocates are less convinced that they are being listened to and frustration with Canadian securities regulators runs high.

iii. How Representative Are Consumer Advocates?

Consumer advocates have the potential to be effective channels of communication between regulators and retail investors. However, many of the Canadian regulators spoken to questioned the representativeness of many of the consumer advocates, although not their commitment. There is a strong perception among regulators that many consumer advocates' concerns relate too much to their own personal experiences and grievances. Further, that those who have developed a commercial side have also developed a conflict of interest in some areas, campaigning on issues that are important for them but are not that significant for most people. The following comments are typical:

‘We do have representative bodies, but they press their own agendas and interests – it’s hard to know how representative they are. You don’t know whether they are just pushing a personal agenda, or agenda of their membership – but that’s a very small proportion of all retail investors.’

‘It’s hard to figure out their [consumer advocates’] agenda, and they can be completely unrealistic as to costs.’

‘There’s a selection bias, as we only ever hear from those who have problems. We don’t hear from those that know what they’re doing or don’t have a problem but might still have views or needs from the regulation that aren’t being met... We still have selection bias, or we may do, we don’t know.’

‘It’s hard to hear the silent majority.’

Consumer advocates in contrast argue that the issues that they are raising are just the ‘tip of the iceberg’. That there are many more consumers being affected by poor practices by the industry than either the industry or the regulators are aware of. Thus whilst personal experiences may have prompted their activism, they are simply giving voice to the experiences of many other people who do not come forward.

The lack of credibility of some consumer advocates in the eyes of the regulators leads to a high degree of mistrust and hostility. This clearly impedes consultation. Both regulators and consumer advocates need to develop better relationships of trust if consultation and participation is to be effective.

iv. Creating a Stronger Consumer Voice in Canadian Securities Regulation

One recurrent proposal for the creation of an independent consumer organization in financial services is for the creation of a Financial Consumer Organization (FCO). This was proposed by the Canadian Community Reinvestment Coalition in 1997,¹²⁴ and recently reiterated by Democracy Watch in 2005, giving evidence to the recent Ontario legislative hearings on the financial sector.¹²⁵ The FCO would be a federally-chartered, not-for-profit organization designed to represent and educate consumers on financial services issues. The FCO would advocate for a 'fair service' from financial institutions before the government, regulators and courts, and provide investor education. Its remit would be wider than securities regulation, but would include mutual funds and other securities products.

The FCO model is based on U.S. Citizen Utility Boards (CUBs). These are broad based watchdog and advocacy groups that are run by their members and represent consumers' interests in the marketplace. All of the utilities companies are required to enclose a flyer in their billing envelopes encouraging people to join the CUB, for a small annual membership fee (U.S. \$10-15). Although only 4% of people join, this gives a relatively large membership and, importantly, a budget. Democracy Watch anticipate that if only 4% of bank customers join the FCO, it would have 800,000 members and an Can \$8 million annual budget.

The proposal is for the FCO to be controlled by its members through the election of regional delegates and the FCO's board of directors. The board would hire the FCO's professional staff and determine its policies. It would hire economists, lawyers and other experts to represent consumers. It would also perform an investment education role.

The development of a single, national consumer advocacy organization for securities regulation would be a significant step. Fragmentation of securities regulators continues to hamper advocates' ability to represent consumers adequately across Canada, however. Whilst it is not within the remit of this report to engage in that debate, the enhancement of the CSA as a co-ordinating body for policy making could provide a central organization with which consumer advocates could communicate, and the CSA could increase the extent to which it actively seeks the views of consumer organizations. This would be in addition to the appointment of a CSA IAC, recommended in Section 7.

¹²⁴ See <http://www.cancrc.org/english/pp4sum.html>.

¹²⁵ For details see <http://www.dwatch.ca/camp/fco.html>.

These proposals clearly constitute just one option. Whatever organizational form it takes, however, there is a clear need for the development of a credible, national and coherent voice for consumers in Canadian securities regulation.

v. Summary

There are thus many individual consumer advocates in Canada, and some advocacy groups. However, on the whole the larger, established national consumer advocacy bodies have not been active in securities regulation. This contrasts with the position in Australia, the U.K. and the European Commission. Perhaps as a result, there is some scepticism on the part of regulators, rightly or wrongly, as to the extent to which consumer advocates are truly representative of the mass of retail investors. The mutual mistrust between some advocates and some regulators can act as a significant impediment to the consultation process.

vi. Recommendations

Consumer Advocates

Recommendation #4.1: Regulators and others need to work together to develop a credible, national, well-resourced and coherent voice for consumers in Canadian securities regulation.

Recommendation #4.2: A greater degree of trust needs to be established between consumer advocates and regulators in situations where it is currently lacking.

Recommendation #4.3: Regulators should facilitate cross-jurisdictional engagement with consumer advocates on common issues and policy initiatives.

Recommendation #4.4: Consumer advocates and regulators should engage in collaborative research on consumers' experiences of dealing with the regulated industry and with the regulatory bodies, including complaints processes

9. Weighing Consumers' Interests in Decision-Making

Assuming that the regulator has gained an understanding of retail investors, has engaged in strategies to improve information and education, has consulted retail investors and perhaps even allowed some direct participation in making decisions, the question then arises: how to ensure that any of this makes a difference? Given that regulators have to balance a number of competing considerations, their mandates often require them to balance competing objectives and they are always faced with a range of different views and interests, how heavily do, and indeed should, the interests and needs of retail investors weigh in that balance?

Assessing the extent to which any particular policy does or does not benefit investors is outside the scope of this report. Nevertheless, it is relevant to this report to consider the issues of what structures and processes exist within regulatory bodies to ensure the interests and needs of retail investors are taken into account in their decision making, and how these processes may be evaluated.

i. Embedding Consideration of Retail Investors' Interests in Regulatory Decision Making

All the securities regulators considered in this report have a mandate to protect investors. They are therefore obliged either by statute or, in the case of the self regulatory bodies, by their own constitutions and regulatory recognition orders, to ensure that the needs and interests of investors weigh heavily in their decision processes. However, they are also obligated to maintain market confidence and ensure competitive markets. Regulatory rules impose costs on firms, and so inevitably regulators have to balance the interests of investors against the competing voices of the regulated firms. Obviously matters are not always so black and white, 'them against us', and there may indeed be potentials for 'win-win' solutions. Further, regulated firms are not a homogenous group, and different policy options are likely to create winners and losers within the regulated industry. But the point remains the same: regulators inevitably have to balance these competing views, and reach a judgment on what they consider to be the best action to take.

There are a number of potential ways in which consideration of retail investors' interests could be embedded in regulators' decision-making processes, in addition to having consumer advisory panels or committees. The two principal modes considered here are:

- formal cost-benefit or regulatory impact analyses; and
- other organizational structures and processes.

a) **Formal Cost-Benefit Analyses or Regulatory Impact Assessments**

The regulators varied significantly as to whether or not they had formal cost-benefit or regulatory impact appraisals. None of the SROs has any formal system or set of processes for evaluating the relative costs, benefits or impacts of their regulatory proposals. Informal processes exist, although evaluating these in detail was not possible in this research. In contrast, the Securities Commissions, ASIC and the FSA all conduct some form of economic appraisal of at least some of their proposed rule changes, which are published.

Cost-benefit analyses or regulatory impact appraisals offer a potential framework for securities regulators, in which they can systematically weigh the compliance costs of a proposal against the benefits to investors and others that the proposal is likely to bring. Whether or not they in fact achieve that goal is another question. There is extensive literature on the difficulties and limitations of cost-benefit or regulatory impact analyses. This focuses largely on the difficulties of being able to accurately to quantify costs and benefits to investors that are often intangible, or may include such non-economic costs as impacts on investor health and emotional well being.¹²⁶ Moreover, evidence from the U.K. suggests that cost-benefit analyses are more often than not performed to justify decisions that have already been made, rather than serving as a systematic and rigorous framework for policy making.¹²⁷

Nevertheless, cost-benefit analysis or other forms of economic and impact appraisal do at least offer one relatively systematic, if imperfect, way of assessing the extent to which any policy is calculated to benefit different groups, including retail investors.¹²⁸ The FSA, for example, focuses on the consumer detriment in the market, and under its CBAs compares the changes in consumer detriment to the costs involved in any policy proposal relating to the retail markets. It is also focusing on market structures across the wholesale and retail markets to try to identify the causes of consumer detriment in those structures.

If the cost-benefit analyses are also published, that improves the transparency of the process and provides more information on which consultation and participation can be based.

¹²⁶ See for discussion R. Baldwin and M. Cave, *Understanding Regulation* (Oxford: 1999).

¹²⁷ NAO, *Evaluation of Regulatory Impact Assessments: Compendium Report 2004-5* HC 341 2004-5.

¹²⁸ For discussion see D. Simpson et al, *Some Cost-Benefit Issues in Financial Regulation*, FSA Occasional Paper 12 (London, 2000), available at <http://www.fsa.gov.U.K./pubs/occpapers/op12.pdf>.

b) Organizational Structures and Other Processes

There are other ways in which organizational structures and processes can attempt to ensure that the consumer voice can continue to be heard during the regulatory process.

These can include:¹²⁹

- risk assessments and planning processes to address on-going and emerging consumer issues;
- knowledge management in respect of relevant consumer issues – development of a knowledge base on consumer interests through regular contact with consumer advocates, dissemination of knowledge e.g. of complaints, research conducted by the regulator and others on consumer behaviour etc., across the organization;
- training in consumer interest issues for staff across departments;
- processes for identifying the relevant consumer issues in each activity and policy initiative;
- cross-cutting consumer ‘ambassadors’ or other individuals who are responsible for ensuring that the interests of retail investors have been considered in all the different aspects of the regulators’ work. (These are distinct from the consumer advisory committees and panels considered in Section 7.);
- Processes for ensuring coordination and information sharing between all parts of the organization dealing with consumer issues, including communications, information and education, policy making and enforcement;
- Internal peer review and challenge processes to ensure that consumer interests have been taken into account in decision making;
- Management reporting to the Board on progress against plans, emerging issues and significant consumer disputes / complaints; and
- Benchmarking of consumer interests processes against those in other organizations.

The extent to which these exist in any of the regulators considered is highly variable, and it was not always possible during this research to get detailed information on these matters of internal operation.

However, the Canadian securities regulators reported that on the whole they did not have formal structures and processes for taking consumer issues into account in their decision making, aside from those that had consumer representatives or advisory committees. There are, however, often informal structures and processes, including

¹²⁹ See Ofcom, *Capturing the Consumer Interest: A toolkit for regulators and government* (London: February 2006).

communications with investor advocates, analysis of complaints data, and communications between enforcement and policy divisions, as discussed in the previous sections.

Nevertheless, some do have some more formal processes. The BCSC and the FSA, for example, have teams that focus on emerging issues in the marketplace, and the implications for retail investors amongst others. The BCSC has just formed an Emerging Issues Committee to perform this role.

In the FSA, there is a high level risk assessment done of risks in the marketplace and internationally that might affect firms and the FSA. This is published in the Financial Risk Outlook, and the work is done by a specialist risk division within the FSA.¹³⁰

The FSA also engages in a complex risk mapping process throughout the organization. All staff are required to identify where the key risks to the FSA's statutory objectives are in their area of work. As one of the FSA's statutory objectives is giving adequate protection to consumers, this requires each member of staff, regardless of what division of the organization they are in, to consider whether there are any risks to consumer protection in its work. These are collated and filtered up the organization until a map of the key risks facing the FSA is developed. With the Financial Risk Outlook, this is then intended to form the basis of the FSA's strategy and resource-targeting. In addition, those working in retail markets conduct regular analysis and market reviews to identify the characteristics of 'toxic' products, i.e. those which could pose key risks to retail investors, and other emerging issues that might confer a detriment on the consumer.

The FSA also has cross sector consumer 'leaders' who are responsible for coordinating work on consumer issues across all divisions.¹³¹ Thus whilst it has a separate division responsible for retail markets, there is a cross-cutting consumer director responsible for ensuring that the other two main divisions (wholesale markets and regulatory services) are aware of the impact for retail investors of their policies and those of the firms they regulate.

The evidence for the extent to which regulators embed consideration of retail investor interests in their decision making processes thus shows highly variable processes existing between regulators. Although it has been possible to get a general idea of how each organization works, in depth case analysis of the decision making processes with respect to specific policies would be required in order to gain a more detailed understanding of how these processes and their effectiveness.

¹³⁰ See e.g. FSA, *Financial Risk Outlook 2006* (London, January 2006).

¹³¹ The FSA's organizational chart is set out in its Annual Reports.

ii. Evaluating How Regulators Take Consumer Interests into Account

Methods for evaluating how regulators take consumer interests into account are in their infancy. However, in the U.K., the Ofcom Consumer Panel has recently commissioned PricewaterhouseCoopers, a firm of consultants, to devise a methodology for doing just this: evaluating or auditing the way in which consumer interests are taken into account by Ofcom in the formation and implementation of regulation. The resulting ‘toolkit’ will be used by the Panel in 2006-7 to evaluate Ofcom’s activities.¹³² The Panel commissioned the work as it recognized that it could not shadow every policy and every regulatory intervention, nor would it make sense for it to do so. It therefore decided to focus on whether Ofcom has a fully developed internal capability to understand and give to weight to consumer interests along with industry interests.

The toolkit provides an audit methodology that it hopes will enable it to assess how regulators:

- identify and take account of consumer interests in regulatory policy and development; and
- demonstrate what they have done in addressing consumer interests and the basis of their actions.

The toolkit comprises 31 questions that can be asked of the regulator to determine if the consumer interest is being properly considered. These questions address three areas: organization wide issues; project specific issues and a combination of both types of issues.

The questions focus on:

- organizational issues:
 - defining the consumer interest;
 - risk assessment and planning;
 - training and knowledge management;
- project specific issues;
 - for planned projects:
 - is the plan clear about how consumer interests have or will be addressed?
 - is there a risk assessment to identify the significance and complexity of the issues for consumers?

¹³² Ofcom Consumer Panel, *Capturing the Consumer Interest: A toolkit for regulators and government* (London, 2006).

- are there appropriate processes in place to ensure evidence will be collected and key issues addressed in the final output?
 - for emerging issues:
 - are there processes in place for assessing and logging consumer concerns and reviewing these regularly to ensure they are acted on?
 - are there processes for identifying emerging issues and assessing their urgency of issues?
- organizational and project issues:
 - communications with consumers:
 - are there clear processes and channels of communications with consumers, and for explaining decisions taken?
 - organizational controls:
 - management reporting systems;
 - peer review and internal challenge;
 - performance indicators; and
 - benchmarking against other organizations.

The toolkit was initially piloted in two policy areas in Ofcom. The pilots found that at the time (2004-5) there was no formal process for defining the consumer interest, although one has since been developed, and that some systems and processes for considering the consumer interest existed, but could be enhanced. Ofcom has accepted the report, and is currently investigating ways in which a framework can be developed for ensuring the consumer interest is consistently and appropriately taken into account in its decision making.

iii. Summary

The extent to which formal and informal structures and processes exist within regulatory bodies to ensure the interests and needs of retail investors are taken into account in their decision making is highly variable, and it was not always possible to get detailed information on these issues for this report.

Some regulators, although not the SROs, undertake cost benefit analyses of all or some of their proposed policy changes. Some have some formal organizational structures and processes to identify emerging risks, for example, or coordinate across policy and enforcement divisions, or to utilize complaints data. In others, informal systems may exist. Most Canadian regulators spoken to indicated that this was an issue that they were starting to address. However, many were watching the experiments made by others, particularly the OSC Investor Advisory Committee, before deciding what courses of action they themselves should take.

iv. Recommendations

Embedding Consumer Interests in Decision-Making

Recommendation #5.1: Develop and regularly review systematic processes for assessing, prioritizing and addressing the risks and benefits to consumers of proposed policy initiatives.

Recommendation #5.2: Develop and regularly review methods for systematically assessing the impact of existing policies on consumer detriment.

Recommendation #5.3: Establish consumer director / leader who is responsible for coordinating, assessing and reporting on how effectively consumer interests are taken into account in decision making.

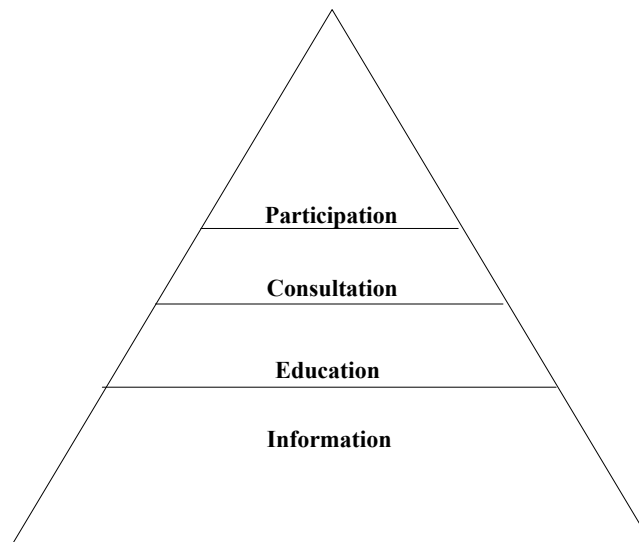
10. Conclusion

The need to enhance consumer involvement in regulatory decision making is being recognized by securities regulators in Canada as elsewhere. Consumer involvement improves the democratic accountability of the regulator, and it can lead to a better quality of decision making. This section brings together the findings of this research, and considers the next steps that may be taken to enhance and embed the consumer 'voice' in the regulatory process.

The Nature of Involvement

Consumer involvement in the regulatory process takes four main forms: information, education, consultation and participation. These form a funnel, as Figure 6 illustrates: as the degree of active engagement increases, the number of consumers involved decreases, as do the opportunities for engagement. Thus information and education processes are open to many more consumers than consultative and participative processes, and are more widely available.

Figure 6: Modes of Involvement



Consumers and the wider public can be involved through any of these means at any stage in the regulatory process:

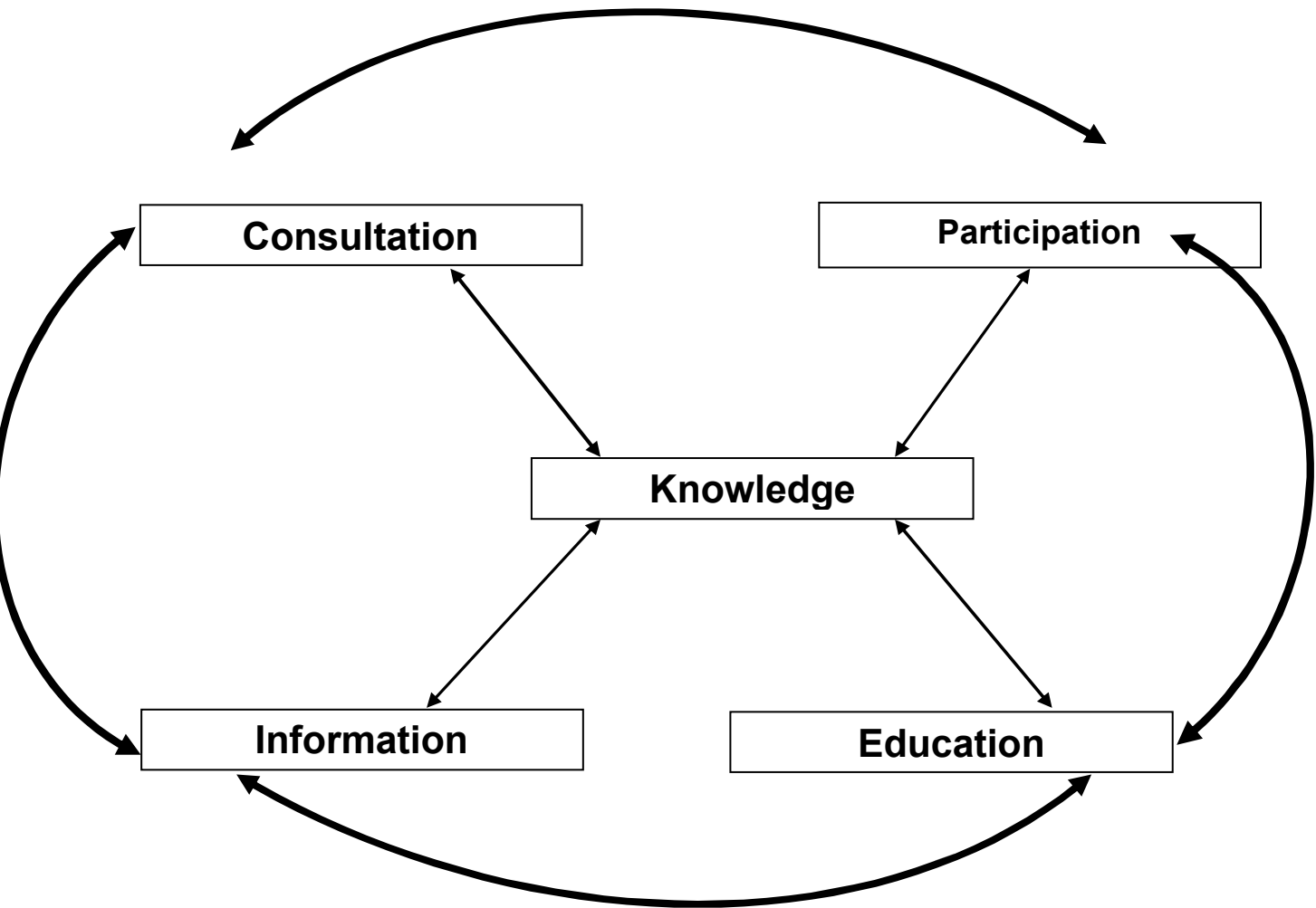
- design;
- implementation;
- enforcement; and
- evaluation.

For the securities regulators examined here, most of the initiatives for involving consumers or the public occur with respect to policy design, but there are also examples of consumer involvement in implementation (at least via complaints data), enforcement (e.g. public interest representatives on enforcement panels), and evaluation (surveys of awareness and confidence in the regulator, and through independent consumer panels).

The different modes of involvement are interlinked, as illustrated in Figure 7. Information and education activities can equip consumers to become more actively involved, help regulators identify existing groups of retail investors, and provide entry points for more active consultation and participation strategies, which can in turn feed back into information and education activities. Indeed, the different modes of involvement may be cumulative: information and education are essential pre-requisites for meaningful consultation and participation.

The key to effective consumer-regulatory involvement is knowledge on the part of both consumers and regulators. Retail investors have to know about the regulatory regime if they are to be able to be effectively involved in it. Regulators have to have knowledge about retail investors' skills, knowledge, behaviour and needs if they are to design regulation that provides them with appropriate protections.

Figure 7: Relationships between knowledge and modes of involvement



Getting Information

Although knowledge on the part of both retail investors and regulators is fundamental to involvement, both consumers and regulators face considerable obstacles in gaining that knowledge.

Nevertheless, regulators are starting to use a wider range of strategies to get information on retail investors. These are principally:

- research, both generic and specific;
- monitoring contacts and complaints;
- leveraging off information and education initiatives; and
- expanding the sources of expertise involved in policy making.

Most of these strategies have developed in the last few years, and / or have become more systematized, although the pattern of use is quite varied across the regulators. Some strategies, particularly research, offer considerable scope for inter-regulatory collaboration especially on generic issues such as financial capability and on national policy initiatives. These are discussed further below.

Modes of Involvement: Information and Education

Information and education are fundamental to other, more active modes of consultation and participation. Regulators need to be informed not only as to the financial capabilities of investors, but also their ‘civic capabilities’: how best to communicate with them; how to access consumers, what kind of language to use, how best to frame questions or issues. Consumers need to be informed and educated about the technical and policy issues involved, and on how to respond to consultations – how to frame their arguments, which regulators to go to, how to develop policy proposals.

At present, most of the focus is on investor information and education with a view to raising financial capabilities. Improving financial capability is critical both for individuals’ financial well-being but also for the efficiency of the market. It is also critical for the economic and social well-being of the community, for the social costs of low incomes and financial fraud can be high.

Improving financial capability could also be seen in a wider sense, as an integral part of a strategy to expand consultation and participation. Some regulators are indeed hoping that their investor education initiatives will provide them with opportunities to identify and connect with groups who so far have been hard to hear, so that they might be brought into the consultation processes.

There has been little attention, by any regulator, on understanding or enhancing the ‘civic’ capabilities of retail investors, however. Regulators, not only in securities, have only partial knowledge as to how best to reach and engage retail investors in the regulatory process, how best to frame questions and issues and to stimulate interest and awareness. There is even less activity on raising civic capabilities through education or training,

even for specially appointed consumer representatives. There is a need for therefore for civic capacity building, discussed further below.

Modes of Involvement: Consultation and Participation

Ensuring active consultation and participation by consumers in regulatory processes is difficult, and requires regulators to move beyond the traditional, paper-based consultation processes.

In addition to notice and comment processes, the main methods used by Canadian, U.K. and Australian securities regulators to date are public meetings, and more focused consultations with groups of investors through focus group research. Although public meetings are common in Australia and the U.K., in securities regulation as in other areas, in Canada only one regulator has held an open meeting specifically for retail investors to air their views (the OSC Investor Town Hall). Focus group research is increasing in all three jurisdictions, however.

Active participation through investor advisory committees or consumer panels do feature in the U.K., Australian and Canadian securities regulation. Two Canadian regulators have introduced consumer representatives into their committee structures: RS and the OSC. The most developed initiative is the OSC Investor Advisory Committee. The IAC's role and institutional structure is quite distinct from consumer panels in Australia and the U.K., however, and with only two meetings under its belt, it is far too early to say how it will develop.

Regulators in other areas and jurisdictions have been experimenting with alternative forms of active participation, such as citizen's juries and other deliberative panels. These are an increasing feature of health, bio-technology and environmental regulation. In these processes, participants are given a course of education on the technical and policy issues in question, and in some cases on how to present formal policy proposals. The outputs of these processes are then fed into the wider policy process. Consultation is thus combined with capacity building and active engagement. These alternative forms of active participation have not been a feature of securities regulation to date in Canada, Australia or the U.K..

The Role of Consumer Advocates

Consumer advocates, either individuals or organizations, can offer potentially valuable bridges between regulators and retail investors. They may provide opportunities for the regulator to get information on the views of retail investors and to communicate with them either directly or indirectly.

There are many individual consumer advocates in Canada, and some advocacy groups. However, on the whole the larger, established national consumer advocacy bodies have not been active in securities regulation. This contrasts with the position in Australia, the U.K. and the European Commission. Canada thus lacks a well resourced, powerful, national consumer voice representing all Canadian retail investors in securities regulation.

Moreover, there is some scepticism on the part of regulators, rightly or wrongly, as to the representativeness of consumer advocates, which in some circumstances can act as an impediment to their effectiveness.

Embedding Consideration of Consumer Interests in Decision-Making Processes

The extent to which formal and informal structures and processes exist within regulatory bodies to ensure the interests and needs of retail investors are taken into account in their decision making is highly variable. Some regulators, although not the SROs, undertake cost benefit analyses of all or some of their proposed policy changes. Some have some formal organizational structures and processes to identify emerging risks, for example, or coordinate across policy and enforcement divisions, or to utilize complaints data. In others, informal systems may exist. Most Canadian regulators spoken to indicated that this was an issue that they were starting to address. However, many were watching the experiments made by others, particularly the OSC Investor Advisory Committee, before deciding what courses of action they themselves should take.

Next Steps

The research findings suggest that Canadian regulators are recognizing that engagement with retail investors can be valuable, and are starting to seek active ways of achieving it. Many, however, are unsure as to which strategies are likely to be the most effective.

Involvement is multi-faceted. There is therefore no ‘silver bullet’, no single strategy that will solve all the problems and meet all the goals. This does not mean that therefore nothing can be done; rather that any

strategy for engaging consumers has itself to be multi-faceted and vary with the purpose for which involvement is sought.

The first step is to break down involvement into its four main modes: information, education, consultation and participation. Enhancing involvement means making enhancements in one or more of the different modes.

The next stage is recognizing that mode of involvement serves a different purpose and has different advantages and drawbacks. Choosing which to use in any particular policy initiative requires recognizing their different purposes and potentials.

The report has made a number of recommendations, summarised in Section 2. There are also a number of key principles of best practice stemming that should be noted in implementing these recommendations, summarised below.

What Works? Key Elements for Information and Education Strategies

Research on information and education initiatives suggests that there are five key elements of success:

- linking with existing community, education or workplace groups;
- tailoring campaigns to the differences in financial literacy and capability of the particular audiences;
- using strategies that get the attention of consumers;
- moving information and education campaigns out of the specialist financial press and into the general media; and
- working with partners to devise and deliver financial information and education.

What Works? Key Elements for Strategies of Consultation

Getting information on consumers' views is necessary but not sufficient for ensuring effective involvement by consumers in regulatory decision-making. Information gathering and information provision do not offer opportunities for dialogue with consumers or provide them with the means to be involved in regulatory processes.¹³³ Consultation and participation, in contrast, can be means by which effective channels for consumer input are embedded into decision-making processes.

¹³³ See NCC, *Involving Consumers*; OECD, *Citizens as Partners*.

As noted in Section 4, there are different forms that consultation processes may take and many of these - such as focus groups, multi-stakeholder negotiations, and targeted briefings - require more proactive engagement than the standard notice and comment processes. They are clearly therefore more resource intensive for the regulator. Deciding which strategy to use is therefore partly a strategic and resource consideration and partly a question of the role consultation is meant to serve.

In a targeted framework, more resources should be put into consultations with retail investors where the impact of the policy is likely to be greatest on them. Indeed, this has been the general criteria that regulators have used in determining when to commission research. It could be extended to choosing between a wider range of alternative consultation methods.

Key questions regulators could ask themselves in deciding who to consult might include:

- what is the purpose of consulting investors, and what role do we want the outcomes of the consultation to play in the decision process?
- on which groups of investors are these proposals likely to have the most impact?
- in which community, workplace or other groups are these investors likely to be involved, and who do we need to connect with in those groups in order to access them?
- what kinds of approaches are likely to get the attention and involvement of these groups?
- what kinds of support (financial, time, knowledge) will the target groups need in order to engage effectively in the consultation process, and how can we ensure this is provided?
- how can the consultation strategies we use be evaluated?

Federal governments in Australia and Canada and the U.K. government have all produced principles on which the consultation processes should be based.¹³⁴ Whilst not identical, they all emphasise the following:

- consultation should be a ‘first thought not an afterthought’ and embedded in decision making from the start;
- consultation should be based on trust and cooperation, with clear parameters set on the role of each participant in the consultation process and their input into decision making;
- consultation documents should be as simple and concise as possible;

¹³⁴ In Canada, these are the *Consultation Guidelines for Managers in the Federal Public Service* (Ottawa, 1992), available at http://www.pco-bcp.gc.ca/raoics-srdc/docs/publications/consultation_guidelines_e.pdf. In the U.K. see Cabinet Office, *Code of Practice on Written Consultations* (London, 2001) [AUSTRALIA]

- consultation should be with as wide a range of people and groups as possible;
- there should be equal access to timely and relevant information that is easily understandable;
- sufficient time should be built into the policy process to allow for considered responses;
- responses should be analysed and feedback given on the views given and reasons for decisions taken; and
- consultations should be monitored and evaluated.

In particular, the Canadian federal guidelines also emphasise the need to build civic capacity amongst consultees, viz.:

- financial support may be needed to particular groups to enable them to respond to consultation; and
- participants should be trained in the skills required for effective participation, viz. listening, communicating, negotiation and consensus building.

Consultation can bring significant benefits to the regulatory process: it builds trust and confidence in the regulator, it allows information to be gathered from a wider range of sources, and it can improve the quality of decision-making. Both regulators and those being consulted need to be clear about the purpose of the consultation, however, its parameters, and the role it will play in the ultimate decision. Research has found that people on the whole do not respond to consultations as they feel what they say will not make any difference to the final outcome.¹³⁵ Regulators therefore need to reassure people that their voice will be listened to, even if it may not be determinative.

What Works? Participation Through Consumer Representatives on Panels, Advisory Groups

As noted, the main form of direct participation is through appointments of investor representatives to advisory committees or consumer panels. Exactly what form these take clearly depend on the purposes for which they are established. However, consumer representatives have to have credibility amongst both the public and regulators if they are to be effective.

The U.K. National Consumers Council has conducted quite extensive research on consumer representatives in particular sectors and devised a *Blueprint for Consumer Councils* – essential pre-conditions that it argues have

¹³⁵ NCC, *Putting up with Second Best: Summary of Research into Consumer Attitudes to Involvement and Representation* (London, 2002).

to be met for consumer councils to inspire confidence in consumers.

These provide that consumer councils should be:

- independent of government, regulators and industry;
- effective: their work should be well informed and based on sound research;
- representative of consumers, including disadvantaged consumers;
- transparent and accountable;
- in touch with consumers; and
- geographically representative.

To meet these aspirations, consumer panels need:

- clear powers and duties;
- access to information;
- rights to challenge regulators' decisions;
- duties to operate openly;
- adequate resources;
- research capacity;
- open appointments; and
- links with other consumer bodies.

It is worth noting that the U.K. Department of Trade and Industry and the Treasury have recently made several recommendations for how consumer panels, including the FSCP, should operate. These include:¹³⁶

- developing and publishing clear criteria by which they will prioritize activities;
- conducting rigorous research into those issues that currently have the greatest impact on consumer welfare and are likely to do so in the future and using this in formulating strategies and priorities;
- developing clear and complete forward work programs in consultation with their main stakeholders;
- applying rigorous project and program management techniques to all campaigns and activities and developing excellence in this area, possibly through joint training; and

¹³⁶ DTI / HMT report 2004, paragraph 5.11.

- focusing on the outcomes for consumers of their actions, and the most effective means of securing those outcomes.

Performance Evaluation

The U.K. Department of Trade and Industry and the Treasury have also recommended that consumer panels should assess the impact of their activities and should develop meaningful measures of performance that assess:

- their operational effectiveness over time;
- the outcomes of specific campaigns or initiatives: individual project quality, impact and degree of influence exerted; and
- aggregate measures of impact and reputation.¹³⁷

What Form of Representation to Have: What Questions Should Regulators Ask?

There is no single ‘correct’ answer to what form consumer representatives should take. The independent consumer panel is just one model. What type of representation to adopt depends on the purpose it is to serve.

However, whatever type of representatives regulators choose to appoint, their appointment will only be worthwhile if the representative can actually add value to the regulatory process. The risks otherwise are that both regulators and the representatives waste time and resources on an exercise that is really no more than a token gesture.

In order for representatives to be effective, the relationship has to be reciprocal. Representatives need to be able to effectively represent the views of a wide range of investors. That obviously requires work on their part. But regulators need to work with representatives as well to make the relationship effective.

Getting the best from consumer representatives requires regulators to focus on issues relating to:¹³⁸

- the institutional structure and membership of the body:
 - What role are representatives meant to perform?

¹³⁷ DTI / HMT: *Consumer Voice*.

¹³⁸ See also NCC, *Consumer Representation: Making it Work* (London, 2002).

- What viewpoints need to be represented, and how many representatives are needed? Over 12-15 members and the group risks becoming unwieldy, but a ‘lone voice’ may be lost and appear to be a token gesture.
- Are representatives clear about their role and that of others, the influence they will have, and how they fit into the process?
- What rights, powers, and responsibilities will representatives have, including access to information and resources? Have these been clearly communicated at the outset to all representatives?
- Have precise terms and conditions been given regarding time commitments, expenses, terms of office, etc.?
- building capacity:
 - Have provisions been made to provide training to representatives to help them develop specific skills and confidence? Most research on consumer representatives emphasizes the need for a wide range of training.
 - How is the flow of information to representatives to be managed? Representatives usually stress that they need equal access as the regulator to timely and relevant information, and sufficient time to digest information and consult others.
 - Has appropriate financial provision been made for representatives to use to commission research or consult others? Most consumer panels emphasize the need for an independent budget for research.
- effectiveness and accountability:
 - How will the regulator assess how effective the representatives are in providing a consumer perspective?
 - How can the regulator help representatives be accountable to the wider investing public?

Involving retail investors in the regulatory process is a challenge. It is one, however, which all the securities regulators considered in this report have indicated they are increasingly willing to accept. Resources are being put into information and education initiatives, and there is a move to developing research strategies that can offer better information about retail investors’ financial capability and about the likely effectiveness of particular policies in protecting investors. Some Canadian securities regulators are experimenting with different forms of consultation, and one or two with different forms of participation.

Securities regulators in Canada, Australia and the U.K. have therefore become increasingly aware of the need to increase the involvement of retail investors in the regulatory process. There are still significant challenges

to be met, however. There is scope for the development of more proactive consultation techniques, for example by leveraging off the work being done on financial education. However, regulators may have to engage in some capacity-building to enable different groups to participate effectively in consultation processes. This may require training in advocacy and civic capability as well as financial capability and policy specific issues. There is the potential for organizational structures and processes to be adjusted to ensure that the consumer interest is strongly embedded in all stages of the regulatory process. The new modes of participation being adopted are too nascent to be able to assess, but again some capacity-building may be required. Finally, the need for a strong, national, coherent consumer voice that can represent all Canadians is felt strongly by many consumer advocates and regulators alike. As many are aware, regulators will have to continue to develop pro-active strategies of involvement if they are to ensure the voices of retail investors are heard more widely and more often in the regulatory process.

Appendix 1: Financial Services Consumer Panel – Terms of Reference

The FSA Board agreed the following revised terms of reference for the Consumer Panel on 15 March 2001.

1. The Financial Services Consumer Panel ('the Panel') is established by the Financial Services Authority (FSA) under the Financial Services and Markets Act to represent the interests of consumers. The Panel is independent of the FSA and can speak out publicly on issues where it considers this appropriate.
2. Panel members are appointed by the FSA in accordance with Nolan principles, in order to represent consumers, with HM Treasury's approval in the case of the Chairman. The FSA Board approves the Panel's annual budget and provides a dedicated Secretariat to support the Panel.

Scope

3. The main purpose of the Panel is to provide advice to the FSA. As such it does not carry out responsibilities on behalf of the FSA. For example, the Panel does not undertake consumer education, nor does the Panel take up individual consumer complaints.
4. The emphasis of the Panel's work is on activities that are regulated by the FSA, although it may also look at the impact on consumers of activities outside but related to the FSA's remit.
5. The Panel will have regard to the interests of all groups of consumers including those who are particularly disadvantaged in the context of financial services, including consumers who have little or no access to financial services.

Purpose

6. The Panel will:
 - a) represent the interests of consumers by advising, commenting and making recommendations on existing and developing FSA policy and practices as appropriate;
 - b) speak on behalf of consumers by reviewing, monitoring and reporting to the FSA on the effectiveness of FSA's policies and practices in pursuing its duties;
 - c) keep under review and influence actual and potential developments in financial services to enable it to fulfill (a) and (b) effectively.
7. In addition, it can advise the Government on the scope of financial services regulation.
8. The Panel can consider other matters that assist it in carrying out its primary functions.

Appendix 2: Terms of Reference of the Report

2.1. IDA Proposal for the Research Project

RETAIL INVESTOR INPUT INTO SECURITIES REGULATION

Retail investors often do not have the same economic incentives or opportunities as institutional investors to monitor public companies and their management. In addition, they often do not have effective channels to communicate with regulators, making it more difficult for their views and/or interests to be given proper weight in the consideration of different regulatory options.

Recently, regulators across the globe have attempted to give better “voice” to the retail investor, for example, by holding town hall meetings and by the creation of investor advisory panels.

This research study will explore how regulators currently determine the interests of retail investors in designing regulation. It will also analyze different approaches available to regulators to engage in a more effective and meaningful dialogue with retail investors. Structures that will be explored include the investor panels set up by the FSA and the OSC, surveys with “representative” investors. The role and success (or lack thereof) of consumer advocacy groups may also be considered.

2.2 Agreed Terms of Reference for the Research

Aims and Scope

The aim of the research is to examine how securities regulators in Canada and the U.K. currently determine the interests of retail investors in designing regulation. The end product would be a report in the region of 10-15,000 words (35-45pp) analysing the strategies employed and their input into the policy process.

The report will examine and comment upon:

- current methods of determining the interests of retail investors;
- to the extent information is available, what alternative methods may have been considered and rejected; and
- the views of regulators, those on consumer advisor panels and representatives of consumer advocacy groups as to the effectiveness of the current system as a method for eliciting comment and contribution on and toward prospective policies from the retail sector.

The research will focus on the following regulators and associated consumer panels (where relevant):

Canada

- The Ontario Securities Commission
- Alberta Securities Commission
- Autorité des Marchés Financiers, Quebec
- British Columbia Securities Commission
- Investment Dealers Association
- Market Regulation Services Inc. (RS)
- Relevant consumer advisory groups

U.K.

- Financial Services Authority
- FSA Consumer Panel
- Consumers' Association
- National Consumers' Council

An awareness of other methods of eliciting retail sector comments, particularly methods utilized in Canada, will be important in order to offer advice as to the comparative merits and drawbacks of the various methods currently in use among the principal securities regulators. Comparisons may also be made with the Australian Securities and Investments Commission to the extent this is useful.

Appendix 3: Methodology, Interview Schedules and List of Interviewees

3.1 Statement of Methodology

The research employed a combination of documentary analysis of primary and secondary literature with a series of semi-structured interviews with key officials at the regulatory bodies, consumer advocates and consumer representatives. Interviews were conducted either face to face or by phone during March and April 2006, and lasted from between 30-90 minutes each, with most lasting one hour.¹³⁹ Interviewees were sent a set of questions (below) prior to interview on which the discussion was based. Interview notes were written up immediately following the interview. A draft of the final report was sent to all those who had responded to the interview questions prior to the draft report being completed to enable them to verify facts and any quotes used.

3.2 List of Interviewees

Regulators

Brenda Benham, Special Counsel, Market Relations and New Legislation, BCSC
Noreen Bent, Manager and Senior Legal Counsel, Legal Services, Corporate Finance, BCSC
Paul Bourque, Senior Vice President, Member Regulation, IDA
Patricia Bowles, Director of Communications and Education, BCSC
Connie Craddock, Director of Public Affairs, IDA
Sir Howard Davies, chairman, FSA 1997-2003
Shaun Devlin, Vice-President, Enforcement, MFDA
Doug Harris, Market Regulatory Services Inc
Dame Deirdre Hutton, Deputy Chairman, FSA
Charles Macfarlane, Executive Director, OSC
Anna Larson, Centre for the Financial Services Ombudsman Network (written communication only)
David Linder, Executive Director, ASC (written communication only)
Anne-Marie Poitras, Surintendante de l'assistance à la clientèle et de l'indemnisation, AMF (written comm only)
Carolyn Shaw-Rimington, Communications Project Manager, OSC
Susan Silma, Director, Investment Funds Group, OSC
Paige Ward, Director of Policy and Regulatory Affairs, MFDA

Consumer Advocates, Consumer Representatives and Others

Stan Buell, Director of SIPA
Jonathan Dignan, Public Policy Forum
Bill Gleberzon, Director of CARP and member, OSC Investor Advisory Committee
Harriett Hall, Member, Financial Services Consumer Panel
Louise Hanson, Campaigns Director, Which?
Ken Kivenko, investor advocate
Professor Eric Kirzner, chair, OSC Investor Advisory Committee
Professor Lawrence Kryzanowski, invitee, RS Rules Advisory Committee
Professor Pamela Reeve, member, OSC Investor Advisory Committee

¹³⁹ It was not possible to arrange interviews with representatives of the ASC and the AMF during the relevant timeframes; written responses were received instead.

3.3 Interview Schedule for Regulators

Key Questions for Regulators

In responding to these questions, it would be helpful if you could give specific examples as illustration.

General Approach to Retail Investors

1. Within your organization, what do you consider to be the general awareness of and attitude towards retail investor interests?
2. To what extent is there a working idea of who the typical retail investor(s) are that is common across the organization?
3. Are there policies and procedures for setting out the organization's relationship with retail investors, and controls in place to ensure they are followed?

Processes for Engaging and Communicating with Retail Investors

4. Which parts of your organization deal most often with issues related to retail investors? Is there a specific team responsible for communication with retail investors, for obtaining evidence on retail investor interests and for inputting this knowledge into specific policy projects?
5. How does your organization normally decide what the relevant issues are for retail investors and how significant they are?
6. With respect to which types of decisions are the views of retail investors obtained, for example strategic business plans, contents of annual reports, specific policy proposals?
7. How is evidence on retail investors' views usually obtained, and at what stage in the decision-making process?
8. Are these methods defined in standard organizational processes, or do they vary from project to project?
9. To what extent have methods for communicating and engaging retail investors changed over the last 3-5 years?
10. How effective do you think the different methods are?
11. Once obtained, what processes exist to incorporate evidence of retail investor interests into the decision making process?
12. How are the interests and views of retail investors weighed against other competing interests and concerns in the decision making process? What processes are there to ensure consistency of practice in weighing retail investor interests across the organization?
13. Are such decisions documented and / or subject to internal review?
14. To what extent does the organization attempt to distinguish between the interests of different groups of consumers, and how is this done?

15. What methods does the organization use for communicating and explaining the outcomes of a policy process to retail investors?
16. What methods does the organization have for ex post evaluation of the impact of a policy on retail investors?

For those regulators with related consumer panels

17. How would you describe your relationship with the sector-specific consumer panel?
18. What are the principal methods by which you obtain the views of the panel, and with respect to which types of decisions?
19. What are the processes for responding to the views of the Panel and incorporating them in the decision-making process?
20. Are there ways in which the role of the Panel and its relationship with the regulator could be improved?

Issues / problems

21. What are the main problems in communicating and engaging with retail investors?
22. What other regulatory principles and objectives overlap with and are most in conflict with the interests of retail investors?
23. Does your communication and engagement with retail investors vary over time or across policy issues?
24. What changes, if any, do you think need to be made to the way your organization engages with and pursues the interests of retail investors?
25. What recommendations would you make other regulators as to how to engage with and further the interests of retail investors?

3.4 Interview Schedule for Consumer Panels

Key Questions for Consumer Panels

This is a checklist of issues to be discussed with members of sector-specific Consumer Panels in order to obtain information on how financial regulators engage with retail investors and incorporate their views and interests in the decision making process.

In responding to these questions, it would be helpful if you could give specific examples as illustration.

General approach to retail investors

1. What do you consider to be the general awareness of and attitude towards retail investor interests both within the Panel and within the regulator?
2. To what extent is there a working idea of who the typical retail investor(s) are that is common across the Panel and the regulator?

Processes for engaging and communicating with retail investors

3. How does your organization decide which regulatory initiatives are most important for it to become engaged in?
4. How does the Panel determine what the interests of retail investors are with respect to specific policy issues?
5. What, if any, independent research does the Panel commission to obtain evidence on the views and interests of retail investors?
6. Are the methods for communicating and engaging with retail investors defined in standard organizational processes, or do they vary across policy issues?
7. How does the Panel obtain information on emerging issues in the market that may affect retail investors?
8. How is this information communicated to the regulator?

Relationship with the regulator

9. How would you describe your relationship with the regulator, and to what extent has this changed over time?
10. What are the principal methods by which the regulator obtains the views of the Panel, and with respects to which types of decisions?
11. At what stages in the regulatory decision process are the views of the Panel obtained?
12. What are the processes for the regulator to respond to the views of the Panel and incorporating them in the decision making process?
13. Do you think that the regulator responds adequately to your concerns?

14. How does the Panel evaluate the impact of its activities on the regulatory process?
15. Are there ways in which the role of the Panel and its relationship with the regulator could be improved?

Relationship with complaints-handling bodies / Ombudsmen

16. What is the nature of your relationship with the sector-specific Ombudsman or other complaints handling body? Is this satisfactory?
17. Do you obtain information on the levels and nature of complaints being received, and if so, how is this incorporated into your activities?

Issues / problems

18. What are the main problems in ensuring the views and interests of retail investors are adequately communicated and incorporated in the regulatory decision process?
19. What other regulatory principles and objectives overlap with or are most in conflict with the interests of retail investors?
20. What changes, if any, do you think need to be made to the way the Panel engages with and pursues the interests of retail investors?
21. What changes, if any, do you think need to be made to the way the regulator engages with and pursues the interests of retail investors?
22. What recommendations would you make to other Consumer Panels as to how to engage with and further the interests of retail investors?

3.5 Interview Schedule for Members of Consumer Advocates

Key questions for Consumer Advocates

This is a checklist of issues to be discussed with members of consumer advocacy groups in order to obtain information on how securities regulators engage with retail investors and incorporate their views and interests in the decision making process.

In responding to these questions, it would be helpful if you could give specific examples as illustration.

General approach to retail investors

1. What do you consider to be the general awareness of and attitude towards retail investor interests both within your organization and within the regulator?
2. To what extent is there a working idea of who the typical retail investor(s) are that is common across your organization and the regulator?

Processes for engaging and communicating with retail investors

3. How does your organization decide which regulatory initiatives are most important for it to become engaged in?

4. How does your organization determine what the interests of retail investors are with respect to specific policy issues?
5. What, if any, independent research do you undertake or commission to obtain evidence on the views and interests of retail investors?
6. How do you obtain information on emerging issues in the market that may affect retail investors?
7. How is this information communicated to the regulator?

Relationship with the regulator

8. How would you describe your relationship with the regulator, and to what extent has this changed over time?
9. What are the principal methods by which the regulator obtains the views of your organization, and with respect to which types of decisions?
10. At what stages in the regulatory decision process are the views of your organization obtained?
11. What are the processes for the regulator to respond to the views of your organization and incorporating them in the decision making process?
12. Do you think that the regulator responds adequately to your concerns?
13. How do you evaluate the impact of your activities on the regulatory process?
14. Are there ways in which the role of consumer advocacy groups and their relationship with the regulator could be improved?

Complaints

15. Do retail investors complain directly to you about issues that are within the remit of the securities regulators?
16. How is information on these complaints collated within your organization and communicated to the regulator?
17. What is the nature of your relationship with the sector-specific Ombudsman or other complaints handling body? Is this satisfactory?

Issues / problems

18. What are the main problems in ensuring the views and interests of retail investors are adequately communicated and incorporated in the regulatory decision process? To what extent do these vary across policy issues?
19. What other regulatory principles and objectives overlap with or are most in conflict with the interests of retail investors?

20. What changes, if any, do you think need to be made to the way consumer advocacy groups, including sector-specific Consumer Panels, engage with and pursue the interests of retail investors?
21. What changes, if any, do you think need to be made to the way the regulator engages with and pursues the interests of retail investors?
22. What recommendations would you make to other consumer advocacy groups, including Consumer Panels, as to how to engage with and further the interests of retail investors?

Julia Black
Professor of Law
London School of Economics and Political Science
Houghton Street
London WC2A 2AE
U.K.

Email: j.black@lse.ac.uk

© Julia Black

