

# *Who protects the consumer?*

**Verbal submission to the Ontario Government's Standing Committee on Finance and Economic Affairs**

**Hearings on the Final Report of the Five Year Review Committee  
April 18-23, 2004**

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Mr or Madame Chair(man), ladies and gentlemen,

I have worked for banks and financial institutions in Canada, both as a staff member, and as a consultant and writer. I have written speeches for bank chairmen, such as Matt Barrett and Bill Mulholland, and for various Ontario ministers. I was head of research for a major stockbroker abroad.

I have also written a lengthy report for the Federal government, giving the consumer view of Canadian financial services and ways to transform them. My written submission (copies of which have been passed on to you), was drawn from this Report, which was made public under the name *The Scorpion and the Frog*.

I mention my background to make two things clear:

- **First**, I am not a specialist on the securities industry as such, though I have worked in that Industry. My presentation will not focus on the fine details of securities regulation, but on the overall relationship between consumers and financial services generally.
- **Second**, I am not here as a partisan to criticise the financial services industry on behalf of the consumer. I have worked in and for the financial services industry and believe it provides consumer services as good as any in the world, and quite possibly better than anywhere else.

I recognise the narrow boundaries of this Committee mandate, but want to say at the outset that the consumer does not distinguish between regulatory regimes. The consumer does not care whether something is under the jurisdiction of a provincial or federal government. The consumer wants solutions to problems, not jurisdictional excuses.

Those of us who know the complexity of Canada's regulatory regime may think the consumer's demands are unrealistic. But the desire for a one-stop regulator is deep and fundamentally sensible. In the long run, it's the issue Canadian governments must deal with. Therefore my aim today is to try to give you a bird's eye view of the

overall needs of the consumer in an age of increasing financial complexity

In spite of the strength and efficiency of Canadian financial institutions, the consumer increasingly needs help. Apparently simple decisions, compounded over time, can and do make an enormous difference to the financial futures of Canadians. The difference between a secure independent retirement and dependence on welfare can be very small. Compounding does not always work to the benefit of the consumer.

The flexibility and creativity of Canadian financial institutions means they offer a vast range of alternatives to consumers. Paradoxically this bewildering range of options can make the consumer more vulnerable and in need of protection than in countries where the options are few.

So I want essentially to ask one question here today. “Who protects the consumer in Ontario and in Canada?”

Markets depend for their success on the belief of those participating in them. We have to believe that they are fundamentally fair. If we free them up enough to allow widespread dishonesty and unfairness, people will go elsewhere, and they will falter.

One of the questions we asked consumers and Industry respondents for the *Scorpion and the Frog* study was whether they believed financial institutions give consumers advice that primarily meets the need of consumers, or the needs of the industry.

The results were very revealing. If the neutral replies are excluded, a majority of **consumers** thought that the Industry’s advice was slanted to the needs of the Industry.... but the split was only 39% to 26% in favour of the cynics.

The **Industry** thought the reverse. That its advice was primarily altruistic and focused on the needs of the consumer...but the split was even smaller ... 41% to 36%. Nothing really surprising in that, except perhaps the fairly even balance between the views of the cynics and the optimists on both sides.

But then we asked the same question to a group of government regulators, and public servants working within government financial services departments. The results were **astonishingly** different. No less than 60% of the regulator group thought the financial institutions give consumers advice that primarily fits the needs of the financial institutions. Only 14% thought the financial institutions offered disinterested advice to the consumer.

Clearly the Regulators and public servants know something about the vulnerability of consumers that consumers themselves do not know, and that the Industry either does not know or is reluctant to admit. Given that you, as a Committee, and the

regulators whose work you are reviewing, know only too well how vulnerable consumers are, what can be done about it?

A number of solutions have been proposed, including

- ***The encouragement of consumer associations.*** In theory this is an excellent suggestion. In practice, my research of consumer organizations worldwide and my experience of Canadian consumer associations showed that they are weak, underfinanced, and largely staffed by volunteers. Some of these volunteers are knowledgeable and dedicated, but they are the exception.

Worst of all, Canadian consumer associations tend to be co-opted by the very bodies they are meant to oppose, and actively seek out donations and sponsorship money from the Industry.

This is not to suggest that consumer associations have no role. With large and consistent arm's length financial backing from governments, some associations have done good work, most notably recently in the UK.

But note that consumer associations have never been consistently effective over time – even in the US -- without protracted government support of some sort.

- ***Another solution*** suggested to help the consumer of financial services is ***education***. The major provider of this sort of education to date has been the ***Industry itself, which has offered consumer education programs as a public relations service.***

The Canadian financial services industry has in fact spent a great deal of money on consumer education programmes. Some of this money is of course contributed involuntarily... as a result of fines imposed by regulators for a variety of misdeeds against the consumer <p>.

To be fair, however, the Industry has also contributed a great deal of money and time ***voluntarily***, and has done a good job of educating consumers about a variety of industry-wide issues. The Industry is great at such things as telling consumers to diversify their investment portfolios, or that equities are more profitable over time than fixed interest investments, or that credit should be used responsibly.

But when it comes down to a clash of interest between the Industry and the consumer, it is totally unrealistic to expect the Industry to give advice against the particular interests of its bottom line.

- The Industry's nature is to maximise its return on capital, just as the scorpion's nature is to sting frogs. It is not only unrealistic, it is also unfair,

to expect the Industry or the scorpion to act against its nature. Hence the title of the study I referred to earlier, *The Scorpion and the Frog*. Shareholders expect their companies to maximise returns, not to primarily look out for consumers. That's someone else's job.

But whose job is it to look out for shareholders if they can't do it for themselves?

This question comes back to the job this Committee has before it. At the very least, it's obvious that governments have a central role to play. The job of equipping the consumer to deal with an ever more complex investment environment is becoming increasingly important and urgent.

But I would go even further, and suggest that governments, and specifically regulators, have *the* most important job of all. This Committee has an historic opportunity to make a major difference, to take Canada's securities industry into the 21<sup>st</sup> century.

Everyone knows the difficulties, the tortuous regime of clashing and divided jurisdictions. But the Australians had very similar problems, and they overcame them with political will and determination.

We can do the same thing in Canada.

We need a single regulator for securities in Canada, without a doubt. That's within our immediate reach. But, beyond that, the provinces and federal government need to create a single regulator for all financial services.

If you like, do not think of the job ahead of you as looking out for the consumer of financial services. Think of it as cleaning up ineffective and inefficient markets, by making them fairer and more transparent.

Finally since regulation without effective enforcement is worse than no regulation, I'd appeal to you to make sure that in future the regulators regulate, and enforcers enforce. And that those who attempt to distort the markets for their own personal gain get punished with a lot more than a slap on the wrist.

Thank you.

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