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Are tougher RESP dealer rules needed?

Investor advocates argue that scholarship plan dealers should be subject to more stringent regulations

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Scholarship plan dealers (SPDs) have been the focus of regulatory scrutiny for several years, particularly with regard to the sale of group scholarship plans (GSPs), a form of RESP that pools the contributions made by a group of investors.

Investor advocates have been critical of GSPs for a variety of reasons, including GSPs' large upfront sales charges, which usually are non-refundable when an investor cancels their subscription in a GSP before the plan matures. The cancellation rates in these plans can be high, particularly among low-income investors who can't afford to keep up with monthly contribution schedules.

The Canadian Securities Administrators (CSA) launched a proposed three-phase project to update the regulations governing scholarship plans in 2010 — but the project never got past its first phase. In that first phase, the CSA published new rules for scholarship plan prospectus forms that took effect in May 2013.

SPDs now must issue plan summary documents that tell investors how long paying off the sales charges applied to GSPs will take. Those charges often amount to thousands of dollars. Typically, the majority of a subscriber's early contributions goes toward paying down the sales charge rather than being invested. Plan summaries also must include the percentage of the SPD's GSPs that were cancelled before their maturity date over the previous five years.

Fern Karsh, policy counsel and corporate secretary with the Canadian Foundation for Advancement of Investor Rights, says the stronger disclosure rules are "important," but adds that disclosure alone won't ensure parents are fully aware of the risks of investing in a GSP.

"Are immigrants and people whose first language isn't English or French going to have the easiest time understanding a document that's intended to improve disclosure?" Karsh asks. "Or does more need to be done?"

Karsh suggests several improvements could be made to the regulation of GSPs, such as putting a cap on upfront sales charges. "Securities regulators do have a history of evaluating and, in some cases, banning certain fee structures," she says, noting the CSA's recent decision to ban deferred sales charges for mutual fund dealers in every province except Ontario.

Jesse Vu, CEO and financial advisor with Calgary-based Exceedia Consulting Ltd., says GSPs' upfront sales charges could motivate sales reps to act in their own interest rather than in the interest of their clients.

"As an advisor who sells this [product], you are highly incentivized to take advantage of somebody by maxing out how much money they contribute [per month], because your sales charge comes off the top," Vu says. "You shouldn't be having a conversation about saving for education and giving someone a $3,000 bill up front."

Another aspect of GSPs some find troubling is the plans' attrition rates. According to the latest plan summary from Children's Education Funds Inc. (CEFI), an SPD, an average of "40% of the plans in each group were cancelled before their maturity date" over the past five years.

The CEFI document states that subscribers who drop out of their plans before maturity will not be eligible to have their sales charges refunded, and the income earned on their contributions will remain in the investment pool.

Other SPDs have similar rules.

"The people who do collect [on a GSP investment] are doing it on the backs of all the poor kids who dropped out along the way," says Brad Brain, an independent certified financial planner operating under the umbrella of Aligned Capital Partners Inc. in Fort St. John, B.C. "What in the hell kind of tontine is that?”

Brain also questions the qualifications of GSP sales reps. To sell GSPs, reps must pass the Dealing Representatives Proficiency Course offered by the RESP Dealers Association of Canada (RESPDAC). “Having a one-course qualification, to me, is woefully inadequate,” Brain says. “To release these people on the maternity wards of the country saying, ‘This is what you need for your infant child’ is an accident waiting to happen.”

Paul Renaud, executive director of RESPDAC, stated via email to Investment Executive (IE) that the proficiency course for scholarship plan sales reps is approved by the CSA. He added that RESPDAC believes the scholarship plan industry is “well-regulated in its current form.

“Firms have robust [know-your-client] and suitability processes in place, provide clear and detailed disclosure to customers at the point of sale and require dealing [reps] to complete comprehensive proficiency and product knowledge training, both when first registered and on an ongoing basis,” Renaud’s email states.

But a 2018 report on the regulation of GSPs, published jointly by the non-profits SEED Winnipeg Inc. and Momentum (Calgary) as well as Winnipeg-based Menno Simons College, suggests that these plans often are unsuitable investments for the people who buy them.

The joint report notes that in 2018, the average pre-maturity cancellation rates disclosed by Canada’s five GSP dealers for the previous five years ranged from 10.6% to 44%. Two GSP dealers had average pre-maturity cancellation rates that exceeded 40% during that time frame.

“The high rate of plan cancellation suggests that these plans may have been unsuitable for many of the subscribers to whom they were sold,” the joint report states.

The report adds that interviews with 48 low-income GSP investors in Winnipeg and Calgary revealed that several “felt pressured to invest more money into the group plan RESP than they were comfortable investing.”

Forty per cent of the investors who were interviewed for the report said they “experienced difficulties” in meeting their contribution schedules — a number in line with the attrition rates published by some SPDs.

The CSA might have addressed such issues had its plan to update scholarship plan regulations progressed past the first phase. For Phase 2, the CSA had planned to create a new operational rule for scholarship plans, replacing National Policy 15: Conditions Precedent to Acceptance of Scholarship or Educational Plan Prospectuses.

An email to IE from the CSA states that after completing Phase 1 of the scholarship plan project, “the CSA decided to focus on approaches to implement solutions to outstanding issues rather than work on a new operational rule for [scholarship] plans.”

After the CSA abandoned its regulation update project after Phase 1, the regulator went on to require SPDs to file an undertaking with their renewal prospectuses. The undertaking expands the school eligibility rules for scholarship plans, allows scholarship plans to invest a limited amount in equities and requires SPDs to use the Ombudsman for Banking Services and Investments for resolving investor complaints.

In the third phase of the CSA’s original plan, the regulator would have considered whether SPDs should belong to a self-regulatory organization (SRO). The SRO idea resurfaced last month, when the Mutual Fund Dealers Association of Canada (MFDA) published a discussion paper pitching the CSA on the formation of a single SRO that would be staffed by members of the MFDA and the Investment Industry Regulatory Organization of Canada (IIROC).

The proposed SRO would have oversight of existing MFDA and IIROC members, portfolio managers, exempt market dealers and SPDs. Karen McGuinness, senior vice president of member regulation, compliance, with the MFDA, says having a single SRO that oversees all investment dealers would “create a level playing field.”

But Brain questions whether SRO oversight of SPDs would in fact benefit investors: “If we still have virtually untrained people selling crappy products, [will that] actually make a difference?”

The CSA’s client-focused reforms (CFRs), which will be fully implemented by the end of 2021, could make a difference. An email to IE from the CSA states that the CFRs will require SPDs to “put the client’s interest first when determining the suitability of investments and to address material conflicts of interest in the best interest of the client.”

As for how SPDs will ensure they’re in compliance with the CFRs, Renaud’s email states: “I know that senior compliance leaders from the various dealers are meeting to review the [CFRs] together to help ensure the reforms are applied consistently across the various firms.”

Brain says the key to protecting investors in GSPs is beefing up sales reps’ qualifications.

“There are probably some phenomenal pooled RESP representatives out there, but I also think there are a bunch who aren’t,” Brain says. “If we can get those guys up to a professional standard, that’s going to be a benefit to the average Canadian who wants to educate their kids.”