

**THE CANADIAN COUNCIL OF INSURANCE REGULATORS
AND
THE CANADIAN INSURANCE SERVICES REGULATORY
ORGANIZATIONS**

INDUSTRY PRACTICES REVIEW COMMITTEE

**RELATIONSHIPS BETWEEN INSURERS AND SALES INTERMEDIARIES
CONSULTATION PAPER**

June 3, 2005

EXECUTIVE SUMMARY

Ce document est également disponible en français.

EXECUTIVE SUMMARY

What is the Issue?

Since late 2004, a number of U.S. regulators and state governments have investigated and taken legal action against a number of insurers, brokerages and individuals, alleging fraudulent, coercive and dishonest practices in the sale of insurance products. These practices include the alleged rigging of bids for insurance and concerns about the payment of contingent commissions and other sales incentives.

The Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO), which are associations of insurance regulators and of insurance intermediary licensing and regulatory authorities in Canada, decided to conduct a review of the relationship between insurers and insurance sales intermediaries (such as brokers and agents). The main objective of this review was to determine if issues similar to those in the U.S. could arise in Canada, and to identify opportunities to enhance public confidence in the Canadian insurance marketplace.

In October 2004, CCIR and CISRO established the Industry Practices Review Committee (IPRC) to examine the financial relationships between insurance companies and their sales intermediaries (e.g. contingent commissions, ownership and financial links, and sales incentives) that have the potential for creating conflicts of interest. The main tool for the IPRC review was a detailed market conduct questionnaire for insurers. The questionnaire examined various aspects of the relationship, including the payment of contingent commissions, sales incentives and ownership linkages and focused on the corporate governance issues of insurers, including the existence of policies and the monitoring and approval of policies.

Concurrent with this exercise, the Registered Insurance Brokers of Ontario (RIBO) developed its own questionnaire that was distributed to Ontario licensed property and casualty (P&C) insurance brokers. The RIBO survey requested information on markets, volumes and direct or indirect financial interests in the brokerage by an insurer, including share ownership and/or loans made by insurers. It was intended to complement the IPRC's review and add context to discussions on the practices and financial arrangements between P&C brokers and insurance companies. Concurrent with the release of this consultation paper, RIBO is releasing a report on its survey, which is available on the RIBO website (www.ribo.com).

In Québec, the Autorité des Marchés Financiers (AMF) developed questionnaires for insurance companies and sales intermediaries licensed in Québec. Where compatible, responses from insurers received by the AMF have been included in the IPRC's questionnaire results reports. On April 14, 2005, the AMF released a report entitled, *Commercial Practices in the Québec Damage Insurance (Property & Casualty) Brokerage Sector*, which is available on the AMF website (www.lautorite.qc.ca/accueil.en.html).

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The AMF is expected to undertake a public consultation process on proposed regulatory options. The consultation is scheduled for the beginning of September, 2005. The related documentation will go out to stakeholders in early Summer 2005. The results of the consultation will be compared to those of the CCIR and CISRO at the CCIR Fall meeting in an effort to harmonize policy approaches across jurisdictions in Canada. The AMF also intends to analyze the Life and Health (L&H) insurance industry. The AMF has indicated that it will send a complementary questionnaire to intermediaries in the L&H sector.

The purpose of this paper is to outline the findings of the market conduct questionnaires, and to ask stakeholders for feedback on possible new regulatory responses.

Summary of Findings

General Findings:

- Most insurers have written policies and procedures in place governing compensation to brokers, agents, and other sales intermediaries.
- No evidence of any illegal insurance related activity was found. Regulators continue to monitor the marketplace and will take any action necessary if illegal activity is alleged or detected.
- The IPRC believes that some current business practices may contribute to a perception of or actual conflicts of interest in the marketplace. At issue is the appearance to a reasonable, informed, third party that bias exists in the course of providing advice to consumers due to a conflict of interest or potential conflict of interest. This may have a negative impact on consumer confidence in the insurance marketplace.

Findings Specific to the P&C Insurance Questionnaire:

- The majority of companies use brokers to sell their insurance policies.
- Insurance companies use standard contracts with the brokers that undertake to sell insurance on the company's behalf.
- More than two-thirds of insurers in Canada offer contingent commissions to their agents or brokers.
- The use of non-monetary sales incentives (e.g. learning retreats, workshops and golf tournaments) appears to be minimal with a few exceptions.
- The majority of insurance companies have policies and procedures in place to mitigate the potential for conflicts of interest.
- More than half of the companies report having loans, ownerships and other similar financial relationships with sales intermediaries.

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Findings Specific to the L&H Insurance Questionnaire:

- The majority of companies use career agents, agents (managing general agents, associate general agents and personal producing general agents) and brokers to sell their insurance policies.
- Insurance companies use standard contracts with the career agents, agents and brokers that undertake to sell insurance on the company's behalf.
- The use of sales incentives, including non-monetary sales incentives paid to agents and brokers (e.g. learning retreats, workshops and golf tournaments) appears to be universal.
- All L&H insurers in Canada offer bonuses to their career agents, agents or brokers.
- Companies representing more than half of the market share report having loans, ownership and other similar financial relationships with sales intermediaries. Loans and advances can be in different forms, including funds that are owed to the insurer as a result of a draw against commission or a lapse repayment.
- Companies representing the vast majority of the L&H business have policies and procedures in place to mitigate the potential for conflicts of interest.

Possible Policy Options

The IPRC's general policy objective is to reduce the opportunity for actual and potential conflicts of interest in the marketplace while working to promote consumer confidence. This consultation paper outlines a range of possible policy options which the IPRC feels have the potential to balance the business objectives of market participants and the interests of consumers, thus promoting market confidence.

The IPRC suggests that similar standards be applied to both the P&C and L&H insurance sectors, unless there are obvious and compelling reasons to establish separate standards.

This paper does not make specific recommendations but asks for feedback on a number of policy options. The policy options considered in this consultation paper are:

1. Codify the priority of the client's interest;
2. Restrict performance-linked benefits offered to intermediaries; and
3. Enhance transparency of compensation, ownership and other financial interests.

(1) Codify the Priority of the Client's Interest:

- Codify a requirement in legislation or regulation that the client's interest be placed above those of the intermediary or third parties.

(2) Restrict Performance-Linked Benefits Offered to Intermediaries:

- Introduce legislation or regulation to restrict insurers from offering performance-linked benefits to their sales intermediaries and similarly to restrict sales intermediaries from accepting performance-linked benefits from insurers. The restriction could be absolute or it could be limited by introducing appropriate controls and qualifications on these benefits (e.g. setting a maximum dollar amount or frequency).

(3) Enhance Transparency of Compensation, Ownership and Other Financial Interests:

- Enhance disclosure of compensation, ownership and other financial interests by legislation or regulation; or
- Work with both the P&C and L&H industry associations to develop best practices for disclosure on a Canada-wide basis.

Scope and Applicability of Policy Options to Intermediaries

The policy options could be applied to:

- (i) only intermediaries who hold themselves out as being independent; or
- (ii) all intermediaries, where possible.

Next Steps

The IPRC invites comments from all interested stakeholders as they pertain to the issues and policy options presented in the consultation paper. The IPRC is also looking for input on whether any action is required and suggestions for additional policy options.

If you would like to provide comments, the IPRC strongly encourages you to review the full consultation paper, which can be found at www.ccir-ccrra.org. The full consultation paper includes questions for stakeholders, and seven appendices: (i) a possible disclosure table; (ii) industry initiatives; (iii) P&C and L&H questionnaire results across Canada; (iv) P&C questionnaire results; (v) L&H questionnaire results; (vi) list of CCIR members; and (vii) list of CISRO members.

After collecting stakeholders' comments and suggestions, the IPRC may recommend that CCIR and CISRO propose to governments the policy options described in this paper, or other options proposed by stakeholders during the consultation. Following the consultation process, individual provincial and territorial insurance regulators will review the stakeholder input with their respective governments to determine what action, if any, is required.