



March 24, 2006

Carol Shevlin
Policy Manager (A)
CCIR Secretariat
5160 Yonge Street, Box 85
17th Floor
Toronto, Ontario
M2N 6L9

Submitted by e-mail

Re: Industry Practices Review Committee Consultation Paper on Managing Conflicts of Interest – Joint Submission

By this paper, State Farm Insurance Companies, Co-operators General Insurance Company and Allstate Insurance Company of Canada, are providing a joint submission to the Canadian Council of Insurance Regulators (CCIR) and Canadian Insurance Services Regulatory Organizations (CISRO), in response to the consultation paper, *Managing Conflicts of Interest: A Consultation Paper on Enhancing and Harmonizing Best Practices* issued in February, 2006 (the "Consultation Paper").

As three of the largest direct writer P&C insurers in Canada, having a combined direct premium written for property and casualty business of \$3.1 billion, and providing our products and services through the exclusive agent/direct distribution channel, we have a commonality of interests in this matter.

It is very encouraging that insurance regulators and industry representatives have continued to work closely together over the past year to address issues around transparency and disclosure. Consumers deserve nothing less than complete openness and transparency from the insurance industry and its representatives. It is incumbent upon the industry to earn the trust and confidence of consumers through education and information on the methods used to assess risk, the products and services that are offered and clarity around the means by which these products and services are distributed and delivered.

The Consultation Paper in response to feedback from the industry on the issue of managing conflicts of interest does provide a framework of principles on transparency and disclosure, which the insurance industry could work within. However, the issues that underlie the principles require clarity regarding which distribution channel this document should pertain to.

State Farm, Co-operators and Allstate strongly believe that in the current debate over conflicts of interest in insurance distribution, the necessary clarity with respect to the role and function of the separate and distinct distribution channels (broker vs. agent /direct

channels) has to date not been captured. We believe that this distinction needs to be acknowledged as the additional recommendations that the Consultation Paper will likely generate could, at worst, have serious negative implications for the direct channel and its customers, or at best create confusion in the marketplace.

The role of the captive agent is exclusive to one and only one company. Provided that full disclosure of the exclusive arrangement is made to consumers, the concern with respect to conflicts of interest in the relationship between the intermediary and consumers simply does not exist. Brokers on the other hand, must evidence means through which they can address inherent conflicts between their own interests and those of the consumers they service whenever commissions or other benefits to the broker are more favourable with one insurer than another. None of these inherent conflicts arises in the case of agents that deal exclusively with one insurer. In our view, this distinction is significant from a regulatory perspective.

In the current debate, other regulatory bodies have acknowledged the distinction between the two channels. In April 2005 the Autorité des Marchés Financiers (AMF) released its paper which outlined current business practices in the insurance industry in Québec. In it the AMF clearly stated that, *“The products in question are offered through two distribution networks: brokerage firms and insurers that sell directly to consumers.”* The paper goes on to distinguish the two channels. *“Direct insurers are those who generally sell their products through salaried employees working in a call centre, for example, or through agents who sell only their products.”* (emphasis added). A “broker” on the other hand is described as *“an intermediary between the insurers and the insured parties who must advise his clients and offer them the product that best suits their needs.”* (emphasis added).

The recommendations for areas of change contained in this paper all address the “broker” distribution channel and the inherent conflicts associated with an independent broker’s activities. It further recommends introduction of a legal concept of “independent broker” and states that *“Brokers wishing to use this title would have to comply with specific rules to obtain and keep the title.”*

On March 9, 2006, the AMF released a series of proposed regulation amendments that again acknowledged the distinction between the channels. The proposed amendments differentiate between “agents” and “brokers”. Exclusive agents are exempt from certain of the proposed new disclosure requirements provided they have complied with their own specific statutory requirement to disclose the fact that they act for one insurer exclusively.

In the United States, where CCIR’s counterpart, the National Association of Insurance Commissioners (“NAIC”) in addition to legislative organizations such as the National Conference of Insurance Legislators (“NCOIL”) have taken up the same debate there has been a recognition that new regulatory requirements should not be spread across the entire universe of insurance intermediaries. In fact, NAIC’s model law on the subject places the most rigorous requirements only on those intermediaries who take a fee from both the customer and from the insurer in the same transaction. In contrast, much less is required of agents representing only a single company and, in the case of NCOIL’s amendment to the NAIC model, no such disclosure is required of agents.

We believe that the precedent has been set which provides the regulators and industry associations with an opportunity to establish a measure of consistency in recognizing the distinction between the two channels at a national level.

Further, we believe that captive agents should be excluded from guidelines or initiatives that are designed to address inherent conflicts of interest in the relationship of independent brokers and the consumers they represent.

At the request of the CCIR/CISRO we have provided a response and recommendation to each of the three questions posed in the consultation paper.

1. Do you feel that the principles or outcomes outlined in this paper reflect appropriate best practices in managing potential conflicts of interest?

Overall, we believe that the principles in the Consultation Paper strongly support transparency, disclosure and priority of the consumer's interest. In fact, since early 2005, the insurance industry has willingly, openly and proudly engaged in a level of transparency and disclosure that is unprecedented in Canada and the principles outlined in the Consultation Paper augment those initiatives that are underway.

However, with respect to the application of the principles that have been outlined, we believe it is necessary for regulators to give due consideration to the particular circumstances of the broker or agent in question and the type of product being sold. For example, in Ontario, there are distinctions between (i) brokers licensed under RIBO (who generally own the book of business), (ii) life agents licensed under the *Insurance Act* (who are dealing with a variety of products that are quite distinct from A&S and P&C products), and (iii) non-life agents (who, under section 393(12) of the *Insurance Act* are authorized to act for one insurer only).

In addition, we believe that if recommendations for regulatory changes are made without clarifying the distinction between the agent and broker there could be negative consequences for direct writers and their ability to effectively serve Canadian consumers. The obvious distinction between an agent that works exclusively with one insurer and a broker who has the ability to contract with many should be recognized irrespective of the difficulties inherent in tackling the nature and definition of "independence" which is a challenge unique to the broker channel alone. The distinction between exclusive agents and brokers is a matter of fact and, in jurisdictions such as Ontario, a matter of law.

This distinctiveness of the direct channel is further evidenced by the voluntary Codes of Ethics which have been in place for many years in our organizations, and which we continue to review, update and impose with respect to oversight of our exclusive agents and their relations with customers. By contrast, insurers do not impose such standards on brokers. In the case of the broker, it is the association, such as RIBO, that imposes such standards. For direct writers, these Codes are explicit in addressing the obligations to adhere to strict standards and principles regarding transparency, disclosure and client interest. Our singular relationship with our agents enables us to leverage the requirements, and to impose consequences if they are broken directly. In effect we are, today, clearly working within the direction provided by the CCIR under the current proposed principles in the Consultation Paper, and will continue to do so.

The first principle presents an example of an ideal around which there can be substantial agreement but which can result in serious unintended consequences in its implementation. Any codification of the priority of a client's interest in the financial services context may cause courts to interpret the law or regulation as imposing a fiduciary duty on the intermediary where this was not previously the case. In the absence of a statutory or regulatory provision, courts have generally been cautious in finding new instances of fiduciary duty and the IPRC should be equally cautious in making a recommendation that could have that unintended effect. We must keep in mind that exclusive agents have contractual obligations to represent the interests of the insurer with which they work and these obligations should not be undermined by principles that appear not to be based on consumer needs.

Therefore, in our view it is necessary and reasonable that the distinction between the captive agent and independent broker be taken into account in applying the principles outlined in the consultation paper.

2. Are there practical problems associated with the implementation of the recommendations outlined in this consultation paper?

The CCIR/CISRO Joint Committee is to be commended for spearheading the development of the Consultation Paper, which has provided a thorough and comprehensive assessment of this very important topic. We recognize the challenges of trying to strike the right balance between protecting and educating consumers with incorporating the suggestions and recommendations of insurance companies and industry associations.

The principles outlined in the Consultation Paper strongly support the issue of transparency and disclosure. However, as indicated above, the potential of a 'broad brushed' approach in applying the principles could create problems and confusion for the consumer and the insurer because some of the concerns that the principles attempt to address are not present in all circumstances.

On the issues relating to *priority of the client's interest* (pg 3) and *product suitability* (pg 5) we support the recommendations of IBC and will not expand on those observations here.

The recommended *disclosures of conflicts of interest* (page 4) are not applicable to captive agents. The crux of this joint submission is to highlight this anomaly. It is entirely inconsistent with the current legislative requirement under the *Insurance Act* (Ontario) that non-life agents act for one insurer only to imply that such agents might have some obligation to shop the market for customers who come to them. It should be sufficient in this case for the customer to be clearly informed that the products and services offered by the captive agent are exclusive to the company they represent and no comparison with products of other insurers will be undertaken which, for example, is the approach in Québec.

3. What role could industry associations play in supporting their members in implementing these principles?

We believe industry associations have and will continue to play an important role in helping guide their members through regulatory and legislative issues. However, industry associations must also be responsive and representative of the needs of their particular constituencies in determining how best to implement a set of principles recognizing legislative/regulatory differences.

RIBO, IBAO, and IBAC represent the broker community, CLHIA represents life insurers and IBC represents broad P&C insurance company interests. Each association's members play somewhat different roles in the insurance marketplace and, as such, have perspectives and interests that are distinct from the members of other associations. We therefore believe that industry associations are well suited to assist with implementation – or to work with regulators to implement – desired changes.

Conclusion

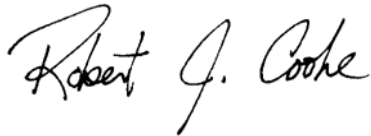
State Farm, Co-operators and Allstate have recognized this as an opportunity to come together as a collective voice to highlight issues of mutual concern that are exclusive to insurers marketing products through captive agents. We are hopeful that our joint submission in response to the Consultation Paper will assist the CCIR/CISRO in understanding the importance of distinguishing the different distribution channels in the face of possible recommendations for regulatory change.

We appreciate the opportunity to share our collective suggestions with the CCIR/CISRO. If you have any questions or would like to discuss our feedback in further detail please do not hesitate to contact us directly. Thank you.

March 24, 2006
Joint Response to CCIR/CIRSO Consultation Paper by State Farm Insurance
Companies, Co-operators General Insurance Company and Allstate Insurance Company
of Canada

Signatories and contact information:

Robert J. Cooke
Senior Vice President
State Farm Insurance Companies



Kathy Bardswick
President and CEO
The Co-operators Group Limited



Michael J. Donoghue
President and CEO
Allstate Insurance Company of Canada



For further inquiry or assistance:

Ray G. Kearns
416-290-4204
ray.g.kearns.alt9@statefarm.com
State Farm Insurance Companies

Jim Wingrove
519-824-4400 ext. 2356
jwingrove@co-operators.ca
Co-operators General Insurance Company

Karyn Toon
905-475-4062
ktoon@allstate.ca
Allstate Insurance Company of Canada