



## **Managing Conflicts of Interest**

---

*IBC Response on the February 2006 IPRC Consultation Paper*

**March 31, 2006**

**TABLE OF CONTENTS**

**EXECUTIVE SUMMARY ..... 3**

**FOUNDATION FOR ACTION..... 5**

*Need for government regulation ..... 5*

*Balance ..... 5*

*Co-operation..... 5*

*Harmonized approach ..... 5*

*Pragmatic solutions ..... 5*

*Cost..... 5*

*Control..... 5*

*Inherent limits to solvency monitoring..... 6*

*Disclosure of information ..... 6*

*Tangible measures ..... 6*

**INTRODUCTION..... 7**

*Code of Consumer Rights and Responsibilities ..... 8*

*Standards of Sound Marketplace Practice..... 8*

**RESPONSE TO QUESTION #1..... 11**

*IIRC Recommendation #1: Priority of the client’s interest..... 11*

*IIRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest..... 12*

*IIRC Recommendation #3: The recommended product must be suitable for the needs of the consumer  
..... 12*

**RESPONSE TO QUESTION #2..... 14**

*IIRC Recommendation #1: Priority of the client’s interest..... 14*

*IIRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest..... 14*

*IIRC Recommendation #3: The recommended product must be suitable for the needs of the consumer  
..... 15*

**RESPONSE TO QUESTION #3..... 16**

*IIRC Recommendation #1: Priority of the client’s interest..... 17*

*IIRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest..... 17*

*IIRC Recommendation #3: The recommended product must be suitable for the needs of the consumer  
..... 17*

**CONCLUSION ..... 18**

## Executive Summary

Canada's home, car and business insurers accept the challenge to manage conflicts of interest. To accomplish this, IBC sees voluntary industry initiatives taking a paramount role and we appreciate the recognition that our members' voluntary initiatives have received in this consultation paper. We also see a key role for industry associations in facilitating the achievement of these desired outcomes.

This paper focuses on addressing the three questions brought forth in the consultation paper:

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

IBC applauds the efforts of the IPRC in making principles-based recommendations that focus on market conduct outcomes for property and casualty insurance. Insurers agree with these principles as they strengthen and improve confidence in the insurance industry. In the discussion below we detail how these principles closely align with the industry's recently released Standards of Sound Marketplace Practice (Standards).

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

There are significant issues involved with moving from these principles to implementation. Our industry is distinct from other financial services as mentioned in our previous submission. The Property and Casualty (P&C) insurance industry is a highly competitive industry, offering a pure risk protection product, which does not conform to the wealth management types of services provided by the banking and life insurance industries. Our customers range from business and commercial clients to individual customers each with their own needs and we use a variety of different business channels to offer our products.

By using principles-based approaches along with reliance upon industry standards, problems normally associated with implementation of one-size fits all approaches can be avoided.

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

IBC has taken an active leadership role in addressing concerns about conflicts of interest. Our industry has already shown its commitment to transparency and disclosure by voluntarily improving disclosure on insurers' websites regarding ownership and financial ties with sales intermediaries. IBC and its members are committed to achieving better policy outcomes for consumers and believe that these initiatives support this goal.

In addition to the disclosures described in our previous submission to IPRC on this topic, our industry also recently released industry Standards of Sound Marketplace Practice (Standards) for voluntary take-up by insurers. This initiative will bring our industry's corporate governance infrastructure to bear on the issues under consideration by the IPRC paper. Standards along with the Code of Consumer Rights and Responsibilities will help to better manage conflict for insurance consumers.

IBC is also prepared to help play a role in promoting consumer education. IBC supports initiatives that result in better-informed consumers. We believe that disclosure is a powerful and cost-effective regulatory tool that strengthens industry discipline and instills public confidence. Consumers should have access to the information most relevant to them in choosing a vendor and making an insurance purchase. Together, the industry associations and the regulator can provide customers with educational material about P&C insurance products and questions they should be asking their sales intermediary. These initiatives can be complemented by the efforts of individual insurers and those of brokers and agents and their associations.

## **Foundation for Action**

Insurers appreciate the role that regulation plays in reducing the risk of company insolvency and enhancing public confidence in the financial system. The industry welcomes the opportunity to work with regulators to develop cost-effective supervisory approaches that foster competition and innovation among insurers.

This paper is founded upon IBC's regulatory policy principles, outlined below, and the advice of our Regulatory Balance Steering Committee. It also reflects the outcome of extensive consultation with member companies.

IBC is heartened to find common ground between the objectives of the industry and those of regulators as outlined in the CCIR/CISRO discussion paper and believes that this forms a foundation for constructive and creative dialogue.

### **IBC Regulatory Policy Principles**

#### **Need for government regulation**

Appropriate government regulation reduces the risk of company insolvency and enhances public confidence in the financial system.

#### **Balance**

Efficient and effective regulation provides appropriate balance between intrusive government regulation and strict reliance on market forces.

#### **Co-operation**

Insurers and regulators both have valuable roles to play in the policy-analysis and decision-making process.

#### **Harmonized approach**

There are significant benefits to consumers when regulators harmonize initiatives primarily across jurisdictions – particularly major trading nations – and secondarily within them (federal, provincial and territorial levels of government).

#### **Pragmatic solutions**

Regulators and insurers should focus on pragmatic solutions to regulatory concerns, rather than dwell on philosophical differences.

#### **Cost**

Cost will continue to be an important determinant in evaluating the efficiency and effectiveness of the regulatory system, but not the only factor considered. Also, direct and indirect regulatory costs must be recognized.

#### **Control**

The conduct and management of any insurance company remains the sole responsibility of its senior management and board of directors.

**Inherent limits to solvency monitoring**

While active solvency monitoring can reduce the risk of failure, some companies may still fail because of unforeseen circumstances.

**Disclosure of information**

Disclosure is a powerful and cost-effective regulatory tool that strengthens industry discipline and instills public confidence.

**Tangible measures**

Objective measures of regulatory effectiveness can enhance public confidence in the system and demonstrate good value to insurance consumers.

## Introduction

Insurance Bureau of Canada (IBC) welcomes the opportunity to comment on the February 2006 Consultation Paper titled: *Managing Conflicts of Interest: A Consultation Paper on Enhancing and Harmonizing Best Practices* issued by the Industry Practices Review Committee of the Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO). IBC is pleased to offer feedback on the specific questions posed and to advance the dialogue on effective insurance regulation.

IBC is the national trade association representing the private general insurance industry. IBC members account for 90% of the non-government, property and casualty (i.e., non-life) insurance business in Canada. The private property and casualty (P&C) insurance industry in Canada provides insurance protection for most homes, motor vehicles and commercial enterprises throughout the country.

Over 200 private P&C insurance companies actively compete in Canada. The industry is one of the largest employers in Canada, providing some 100,000 jobs, including positions for independent brokers, adjusters and actuaries. Many others derive income from the payment of insurance claims, including thousands of people working in a wide range of trades and professions such as car repair, construction, medicine, law and accounting. With registered sales of over \$35 billion in 2005, and controlling assets of \$99 billion, the industry is a major part of the social and economic fabric of Canada. Last year the industry paid out \$20 billion in claims, including rehabilitation of those injured in motor vehicle collisions, replacement of stolen goods, compensation for commercial losses, and repairs to homes and damaged vehicles. The P&C insurance industry also works to improve the quality of life in our communities by promoting loss prevention, safer roads, crime prevention, improved building codes, and coordinated preparation for coping with natural disasters.

Our industry has shown its commitment to promote best practices and to working to resolve the issues addressed in this and previous papers. We appreciate that these voluntary initiatives have been recognized and acknowledged in this paper. Our members have introduced voluntary measures to improve transparency and disclosure by utilizing insurers' websites to disclose ownership and financial ties with sales intermediaries among other things.

Further evidence of this commitment can be seen in two important and complementary initiatives that will benefit insurance consumers: revision of the Code of Consumer Rights and Responsibilities to provide for greater notice for consumers regarding changes to their policies; and adoption of the Standards of Sound Marketplace Practice. These initiatives are described below.

## **Code of Consumer Rights and Responsibilities**

The Code of Consumer Rights and Responsibilities (the Code) was introduced by IBC in January 2005 and has been voluntarily adopted by the majority of the insurance industry. This Code is national in scope. Since its adoption, some commercial insurance consumer groups approached IBC requesting greater notice of material changes to their policies. This is an addition to the 2005 Code.

Recently, a specific amendment was made to add the following conditions to our Code:

To ensure customers are properly advised of changes to or cancellation of their policy with advance notice, the following statement was added.

*Under normal circumstances, insurers will advise an insurance customer or the customer's intermediary of changes to, or the cancellation of, a policy, at least 30 days prior to the expiration of the policy.*

To ensure that there is a responsibility attached to this new right, the section outlining the consumers' responsibility to share information was amended to include a timeline for reporting any material changes to the risk.

*To maintain your protection against loss, you must promptly inform your insurance company or broker or agent of any change in your circumstances at least 45 days prior to the expiration of the policy.*

## **Standards of Sound Marketplace Practice**

IBC's Board of Directors also approved Standards of Sound Marketplace Practices (Standards) at its last meeting. The development of these Standards has been a major initiative that has evolved over a period of several years. IBC considers these Standards as a building block in an emerging new approach to market conduct supervision in Canada. The Standards will ensure that the industry's corporate governance infrastructure is brought to bear in ensuring that insurers are delivering the government's public policy objectives.

Every successful risk-based regulatory regime includes some sort of industry standards. IBC believes that developing voluntary industry standards is an essential step in improving both relationships with regulators and policymakers and public policy outcomes for consumers. In essence, the adoption of such Standards will allow provincial market conduct regulators to place greater trust and reliance on the internal corporate governance infrastructure already in place within the industry.

The Standards are intended to constitute a set of guideposts for insurers as they establish their own practices. The Standards provide direction as to the key areas to be addressed along with specific suggestions for items of attention. Insurers that devise creative, innovative or cost-effective ways of meeting the marketplace objectives will establish a competitive advantage that will benefit not only the company, but its customers as well.

While public policy objectives for marketplace regulation have yet to be formally adopted, at various times regulators have articulated the following specific goals:

- ❖ Development of competitive products tailored to meet the ongoing needs of consumers;
- ❖ Informed and transparent sales transactions;
- ❖ Competent and professional insurance representatives that conform to a specified code of ethics;
- ❖ Fair claims settlement and claims handling; and
- ❖ Timely, accessible and responsive complaint handling.

Most insurers already have guidelines and standards in place to ensure appropriate levels of consumer service in each of these areas outlined above. Nonetheless, industry standards provide a consistent and comprehensive framework that will help to focus corporate attention on the specified areas and provide greater confidence that public policy objectives are being adequately addressed. The Standards of Sound Marketplace Practice will also be useful to insurers as benchmarks when carrying out self-assessments and to regulators when assessing insurers' marketplace policies and procedures.

The Standards may also facilitate communication with consumers about insurers' practices, which would foster a more informed and empowered insurance consumer. A recent study by the Conference Board in Canada, entitled "*Building Public Trust in Canadian Organizations*" concluded that organizations wishing to strengthen public trust needed to focus on enhancing their own trustworthiness. Trustworthy organizations have their interests aligned with those of important stakeholders, operate with integrity and have the capacity to fulfill their mandates.<sup>1</sup>

Built into this process, will be an on-going as well as an annual evaluation process to monitor how industry adoption of the Standards is proceeding. This monitoring process by independent parties will provide added assurance to regulators that the process is working.

### **Consultation Process**

IBC has consulted with its members to formulate responses to the three questions that the IPRC posed in its recent consultation paper. The body of the current document is devoted to outlining these responses in terms of the three recommendations put forth by the IPRC.

As the IPRC moves forward with implementing the principles outlined in its paper, IBC requests that the Committee keep in mind that IBC members pursue a variety of business models and distribution strategies. Some members will be submitting supplementary comments. IBC supports the efforts of these organizations to explain in more detail the unique aspects of their business models and urges the Committee to be mindful of the

---

<sup>1</sup> Conference Board of Canada, "Building Public Trust in Canadian Organizations", May 2005

needs of these organizations and avoid taking steps that would be unduly burdensome to one or more distribution channels without providing a clear benefit to consumers.

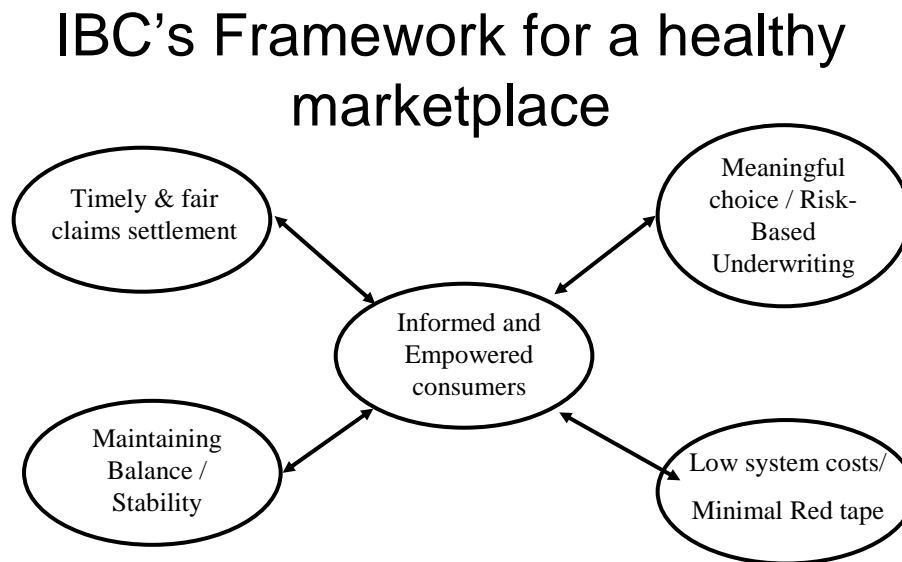
## Response to Question #1 - Do you feel that the principles or outcomes outlined in this paper reflect appropriate best practices in managing potential conflict of interest?

### IPRC Recommendation #1: Priority of the client's interest

We interpret the term “client” to mean policyholders or consumers. IBC supports this principle for all players in the insurance system – not just insurers and sales intermediaries. Consumers are the primary funders of the insurance system and all other stakeholders including governments should place the interest of consumers first.

IBC believes that consumers deserve nothing less than transparency from the insurance industry and its sales representatives. It is incumbent on the industry to earn and maintain the trust and confidence of consumers. We believe customers should know the type of intermediary they are dealing with, whether they represent a single company or multiple companies, and they should be empowered to know what questions to ask their insurance provider.

IBC's Board of Directors has adopted a framework for the insurance industry that places an informed and empowered insurance consumer at the centre of the insurance industry. A graphic of this framework is as follows:



The Standards of Sound Marketplace Practice help to advance this practice:

In particular, the realization of this desired outcome in the marketplace will be supported by Standards #1 and #3.

Standard #1 *Competitive Products Meeting Unique Needs of Consumers* requires that consumers benefit from innovation and competition among insurers to provide viable insurance products and services that meet the unique needs of consumers. In particular, customers are to be treated with consistency, fairness and transparency.

Standard #3 *Competent and Professional Insurance Representatives that Conform to a Specified Code of Ethics* requires insurers to have the necessary policies and procedures that allow the Board and company management to know that competent and professional insurance representatives conform to a specified code of ethics. The purpose of this Standard is to ensure that all representatives of the insurance industry behave ethically and honestly with the public.

We believe that these Standards provide an enhanced alignment between the public policy goals of CCIR members and the activities of insurers. Company by company they will ensure that the interests of clients are put first.

**IPRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest**

Insurers' activities in this area are captured by Standards #2 *Informed and Transparent Sales Transactions*. This standard requires that companies have policies and procedures to ensure that consumers can make informed and transparent sales transactions. The purpose of this standard is to ensure that consumers are empowered and understand what they are purchasing, how the product will meet their needs and, in the case of a policy renewal, understand the factors that may be giving rise to any material change in premium or coverage levels.

IBC supports initiatives that result in better-informed consumers. We believe that disclosure is a powerful and cost-effective regulatory tool that strengthens industry discipline and instills public confidence. Consumers should have access to the information most relevant to them in choosing a vendor and making an insurance purchase.

**IPRC Recommendation #3: The recommended product must be suitable for the needs of the consumer**

In general, IBC supports the concept of product suitability. However, the industry would be concerned if the insurance intermediary were to become obligated to recommend the lowest priced product or to have to conduct a detailed needs assessment, because the assessment of suitability for an individual consumer involves many other factors apart from price.

The term “product suitability” has specific meaning in the financial services industry in sectors such as the securities industry. For example, the Investment Dealers Association of Canada’s Regulation 1330.1 requires its members to “use due diligence to learn and remain informed of the essential facts relative to every customer.” The Regulation also has a specific requirement on “suitability generally” that states that “each member shall use due diligence to ensure that the acceptance of any order from a customer is suitable for such a customer based on factors including the customer’s financial situation, investment knowledge, investment objectives and risk tolerance.”

IBC recommends that the principle be restated in reverse such that the focus is placed on ensuring that products that are “inappropriate” are not promoted. This would eliminate the term “suitable,” which, as indicated above, already has a specific meaning and function in other areas of the financial services industry.

The realization of this desired outcome in the marketplace will be supported by Standard #2. This Standard requires that consumers are empowered and understand what they are purchasing, how the product will meet their needs and, in the case of policy renewals, understand the factors that may be giving rise to any material change in premium or coverage levels. Consumers should have a good understanding of what the product will and will not do for them.

## **Response to Question #2 -Are there practical problems associated with the implementation of the recommendations outlined in this consultation paper?**

With respect to implementation of these recommendations we would like to caution the IPRC that care be taken to ensure expectations clearly distinguish between personal and business consumers as well as consider the separate and distinct role and function of the variety of sales channels available to both sets of consumers. In particular, the recommendations should also acknowledge the role of captive agents that represent one, and only one, company from those that represent multiple companies and products. We do not believe that government policy should benefit one distribution channel over another. The practicalities of the insurance business renewal cycle should also be recognized with a view to ensuring that the requirements placed on companies, agents and sales intermediaries are not costly or administratively prohibitive.

### **IPRC Recommendation #1: Priority of the client's interest**

IBC and its member companies do not anticipate concerns with implementation of priority of client's interest. The concept of placing the client's interest first is a belief shared by our members. There are many codes and industry standards currently in existence to support this principle.

### **IPRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest**

We would like to raise concern about the proposed disclosure requirement that includes the wording "actual or potential conflict". Potential conflict may be difficult to define. Disclosure in advance of all renewal transactions is not always practical and is likely to increase costs significantly to the ultimate detriment of insurance consumers. The majority of renewals are conducted by automated mail and it is unlikely that consumers want to revisit the placement of their insurance annually.

1. Based on the Code of Rights and Responsibility, insurers already make disclosures on their websites and through policyholder mailings on a nation-wide basis. These disclosures reflect information on the kinds of financing and ownership links they have with insurance intermediaries, including direct and indirect ownership, as well as any loans and credit facilities made available to brokerages by insurers. In particular:
  - ❖ *Compensation to insurance intermediaries:* Insurers explain the applicable elements of the compensation they provide to intermediaries, including whether salary is paid, the range of basic commissions, and the range of contingent commissions.
  - ❖ *Ownership and other financing links to intermediaries:* Insurers provide information on the kinds of financing and ownership links they have with insurance intermediaries, including direct and indirect ownership, as well as any loans and credit facilities made available to brokerages by insurers.

The details of disclosures are best left to individual insurers to develop with their distribution partners pursuant to the new Standards. Whatever additional disclosures are required by distributors should be built upon this base.

If a uniform approach is desired, the details of these point-of-sale disclosures should be worked out in dialogue with representatives from distributors on a province-by-province basis.

**IPRC Recommendation #3: The recommended product must be suitable for the needs of the consumer**

As discussed above, we would raise concerns about possible unanticipated consequences or impacts about introducing the term product “suitability” to our industry. This is a term that has existing meaning in our financial services sectors such as investments and could result in unanticipated consequences for our industry. In particular, there could be consequences on errors and omissions insurance that could result from using the term “suitable” depending on how this principle was implemented.

## **Response to Question #3 - What role could industry associations play in supporting their members in implementing these principles?**

IBC and its members believe industry associations can play a key role in assisting both the industry and the regulators in achieving the principles and outcomes outlined in the paper.

This is accomplished in two ways

- 1) Codes and Standards
- 2) Consumer Education

### **Codes and Standards**

As mentioned throughout this paper, IBC has already spearheaded two major initiatives to assist its members with implementation of the IPRC principles: the Code of Consumer Rights and Responsibilities and the Standards and Sound Marketplace Practice. Voluntary industry solutions are the best way to achieve desired outcomes and create meaningful incentives for insurers and intermediaries. For most insurers, compliance is assured not only by public sanction and the potential threat of legal action, but also by the Financial Consumer Agency of Canada (FCAC). The FCAC serves as the watchdog for compliance with voluntary codes for the vast majority of property and casualty insurers that are federally regulated financial institutions. The FCAC's objectives are set out in the Financial Consumer Agency of Canada Act. One of these objectives is to monitor the implementation of voluntary codes of conduct that are designed to protect the interests of consumers of financial institutions, have been adopted by financial institutions and are publicly available.

Regulators would also have avenues they could use to satisfy themselves that the desired outcomes are in place. The complaint reporting system recently introduced in Quebec and Ontario could assist regulators in monitoring complaints related to conflicts or disclosure. Other measures such as mystery shopping and input from consumer groups has also assisted regulators in other jurisdictions. IBC has also established an industry norm for voluntary disclosures of compensation and financial relationships with intermediaries. As discussed, IBC has also taken the lead to establish norms for voluntary website disclosures related to compensation and financing.

### **Consumer Education**

IBC has also been undertaking initiatives to improve consumer education and confidence in the industry and is in the process of redesigning our website to strengthen the information offered to consumers to assist them with their insurance purchases.

### **IPRC Recommendation #1: Priority of the client's interest**

IBC's Board of Directors has adopted a framework for the insurance industry that places an informed and empowered insurance consumer at the centre of the insurance industry.

IBC's Standards and Code of Rights and Responsibility put this into practice. These Standards ensure companies have the necessary policies and procedures in place to ensure that customer's interests are placed first. The purpose of these Standards is to ensure that products meet customer needs and that customers understand what they are purchasing. Standard #1 and #3 in particular relate to this principle.

### **IPRC Recommendation #2: Disclosure of all conflicts or potential conflicts of interest**

Insurers made important, and voluntary, strides forward in January 2005. At that time, insurers in Ontario improved disclosure to consumers by posting enhanced information on company websites. Websites are available nationally for most insurers.

As discussed, we have Standards in place, particularly Standard #2 that applies to this principle.

### **IPRC Recommendation #3: The recommended product must be suitable for the needs of the consumer**

As discussed, IBC's Standards, particularly Standard #2 go a distance toward ensuring that consumers are empowered and understand what they are purchasing, how the product will meet their needs and, in the case of a policy renewal, understand the factors that may be giving rise to any material change in premium or coverage levels.

IBC is committed to supporting and maintaining a set of standards and codes that respond to consumers' needs.

## **Conclusion**

IBC appreciates having the opportunity to provide input on the important issue of disclosure and transparency within the insurance industry.

Insurance companies support this IPRC initiative, as well as the initiative to develop a principles-based approach to supervision. IBC is committed to achieving better policy outcomes for consumers and believes that these initiatives support this goal.

IBC is supportive of the overall direction and the goals of the IPRC recommendations. In particular, we recommend that industry-led best practices, codes, standards, transparency and disclosure continue to form the centerpiece in addressing this issue. If recommendations are to be implemented, care must be taken to clarify expectations for personal and business consumers as well as the role and function of the separate and distinct sales channels available to both sets of consumers. In particular, the recommendations should acknowledge the role of captive agents that represent one, and only one, company. We do not believe that government policy should benefit one distribution channel over another.

In addition to the disclosures described in our previous submission to IPRC on this topic, our industry recently made changes to improve our consumer Code of Rights and Responsibilities and introduced industry Standards of Sound Marketplace Practice that will allow our industry's corporate governance infrastructure to bear on the issues under consideration by the IPRC paper. These Standards are currently being rolled-out for voluntary adoption across IBC's membership.

IBC recommends reversing the term "suitable" such that the focus is placed on ensuring that products that are "inappropriate" are not promoted rather than using the using a term like "suitable" to avoid any pre-conceived definitions already used in other areas of the financial services industry.

IBC has also been undertaking initiatives to improve consumer education and confidence in the industry and is in the process of redesigning our website to strengthen the information offered to consumers to assist them with their insurance purchases.

IBC looks forward to working closely with CCIR and CISRO in the development of a final response to this issue, and to continued collaboration on regulatory harmonization and reform for the benefit of Canadian insurance consumers.