



Canadian Life
and Health Insurance
Association Inc.

Association canadienne
des compagnies d'assurances
de personnes inc.

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To CCIR Secretariat:

The Canadian Life and Health Insurance Association (CLHIA) is pleased to provide input to the consultation paper released by the Canadian Council of Insurance Regulators (CCIR), *An Approach to Risk-based Market Conduct Regulation*.

Established in 1894, CLHIA is a voluntary trade association that represents the collective interests of its member life and health insurers. Our members account for 99 per cent of the life and health insurance in force in Canada and contribute to the financial well-being of millions of Canadians by providing a wide range of financial security products.

At the outset, we would like to commend CCIR for its forward-thinking approach to the evolution of market conduct regulation. Initiating this dialogue is an important step in engaging all stakeholders and moving towards a new framework that is efficient and effective both in terms of regulatory supervision and industry execution.

Principles- and risk-based regulation

The paper notes the challenges in bringing risk-based methodologies (employed by OSFI in terms of prudential regulation since 1999) to market conduct regulation and asks for input on how that might work.

Before commenting on those particulars, we believe a useful first step might be to bring greater clarity to the terminology. "Risk-based regulation" and "principles-based regulation" are used frequently and often inter-changeably. We believe they are different concepts that can complement one another and can be used in an integrated framework.

We offer the following for your consideration.

Under a principles-based regulatory regime, regulators set out desired outcomes through high-level statements that align with public policy objectives. This fosters an environment where marketplace participants can then determine how best to deliver on those outcomes, tailoring them to their own risk profile and business model.

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Risk-based regulation speaks more directly to how regulators supervise. From the regulators' perspective, this involves prioritizing resources towards those areas deemed as posing the greater risks. It also involves encouraging good governance practices by marketplace participants and the adoption of best practices, both of which assist in mitigating risk and allowing regulators to focus on more significant risks. Central to the efficient functioning of such a regime is open and clear dialogue between regulators and market participants.

In a regime that integrates the two approaches, regulators need assurances that marketplace participants have processes in place to assess their own risks appropriately and deliver on expected regulatory outcomes. Regulators also need processes in place to monitor trends that might give rise to new risks. Marketplace participants, in turn, develop processes related to the expected outcomes that reflect the unique risk assessment of their own business models.

Some apprehension exists that new approaches to regulation could merely end up in practice being added as yet another layer to the existing regime. It will be important to ensure that that does not happen, and that a principles- and risk-based regulatory regime does, indeed, foster efficiencies for both regulators and the regulated entities.

We would urge that principles be established on a pan-Canadian basis through CCIR, in consultation with stakeholders. Unless a special situation exists that warrants specific rules, how those principles are applied should be determined, across the country, by market participants. Consistency among CCIR members is also important. Having CCIR principles which individual jurisdictions interpret differently or to which they attach unique rules is counterproductive and would create confusion for marketplace participants.

We offer two examples of how this principles- and risk-based approach already works with respect to market conduct regulation.

Ontario's Regulation 347/04 (s.12) requires that the insurer establish and maintain a system that screens agents for suitability and report agents for unsuitability. The Regulation says nothing about how insurers should meet these requirements, but rather, leaves it up to each insurer to develop a system that is well-suited to its own business model and distribution channels. The life and health insurance industry, through CLHIA, developed a more detailed Guideline (*Guideline G8, Screening Agents for Suitability and Reporting Unsuitable Agents*) setting out what such a screening system might entail. It should be noted that part of the Guideline development process involved seeking the views of regulators to ensure that a common understanding of outcomes existed so that industry standards could support and complement the established regulatory principles. Thus, common industry-wide standards have been established. The assessment tool for



regulators, in monitoring trends, is the reporting that each insurer does when unsuitable conduct is detected.

A second example is the principles for managing conflicts of interest that CCIR and CISRO endorsed in 2006. Companies and the industry as a whole, through CLHIA and other organizations, reviewed their own practices to ensure they appropriately reflected the principles. In the case of CLHIA, two new Guidelines were adopted to support the principles (*Guideline G13, Compensation Structures: Managing Conflicts of Interest; and Guideline G14, Confirming Advisor Disclosure*). The assessment tool for regulators is the survey of agents undertaken in summer 2007 and the survey of companies currently underway.

Outcomes

The paper suggests a series of "micro-level outcomes" and "systemic level outcomes". These appear to set the groundwork for a principles-based regime. In particular, the "micro-level outcomes" relate to the "Principles for Business" established by the UK's Financial Services Authority.

The benefits of such a regime (transparency, alignment with corporate governance, proactivity, systemic focus on marketplace and consumers, increased regulatory efficiency and reduced regulatory costs for market participants) are well set out in the paper.

Regulatory Principles for Risk-based Market Conduct Regulation

The paper sets out six regulatory principles. We will comment briefly on each:

1. **Developing Understanding**
(Question to Stakeholders: Can you suggest any methods regulators could adopt to improve regulatory understanding?)

The paper suggests that the primary tools for contributing to a fulsome understanding of the marketplace would be scans of the external environment through media, independent market analysis and information from other government agencies; identification of consumer and system-wide risks through informal surveys or visits with company management; and information that is gleaned from individual complaints.

This appears to be a reasonable and full list. It would, of course, require an active and integrated approach among provincial insurance regulators. Would some mechanism be established through CCIR?



2. **Reliance on Governance and Controls**
(Question to Stakeholders: Reliance on governance is more easily applied to insurers than to intermediaries. Are there equivalent alternatives?)

The paper suggests that it is the responsibility of Boards and senior management to adopt governance practices, policies, procedures and systems that will lead to successful market conduct outcomes, but wonders how this responsibility would be executed by intermediaries.

Successful market outcomes for intermediary interaction with customers involves satisfied, well-served customers, who have purchased a product that fits their needs and who understand the product. The application of governance practices to intermediaries is accomplished through a variety of measures that establish standards of intermediary conduct and practice. Such measures are set by regulators through mandatory pre-licence training through LLQP programs, required continuing education, regulation and enforcement; by insurers through codes of conduct, monitoring and continuing communication about evolving marketplace issues; and through advisor associations and continuing education to ensure that intermediaries are well aware of their responsibilities (e.g., ongoing licensing requirements such as E&O insurance and Continuing Education; anti-money laundering and anti-terrorist monitoring obligations; specific regulatory obligations in their province; awareness of principles such as the CCIR/CISRO principles for managing conflicts of interest; adherence to codes of conduct set out by insurers and advisor associations). Communication tools include bulletins, seminars and CE courses. Monitoring tools include audits, surveys, and intermediary attestation (e.g. on licence renewal application, or on life insurance applications).

3. **Exercising Judgment**

The paper suggests that, given finite resources, regulators need to address the most important things first.

This is a sensible approach that we support. Developing the appropriate information-gathering tools will be important to assessing and deploying resources on a priority basis.

4. **Risk Assessment and Management**

(Question to Stakeholders: Assessing risk and acting in accordance with that assessment are key aspects of risk-based regulation. In a market conduct context, can you suggest other criteria regulators could use in determining which things are most important?)



The paper suggests that regulators will respond to risks in a measured way and give due consideration to market conditions, risk profiles (participant's size, nature and complexity), key issues, any mitigating action taken by the participant, and past supervisory findings.

We support the criteria outlined. We would also note that, where the risk assessment leads to a determination that enforcement action is required, the regulatory enforcement should be effective and timely. For instance, when an insurer reports an agent for unsuitability, this is a clear red flag of risk and warrants timely investigation and action by regulators.

5. **Selective use of Tools**

The paper suggests that regulators should have access to a broad tool-kit including: diagnostic tools to identify, assess and measure risks; monitoring tools (like supervisory team visits); preventative tools to mitigate identified risks (like letters to the CEO or Board); remedial tools to respond to risks (exercising powers of intervention); and enforcement tools when necessary (revocation of authorizations or prosecution).

The suggested tool-kit is reasonable. We would add one other suggestion and two observations.

Dialogue with stakeholders and the industry, noted under the section on "Co-operation", may often be as effective as self-assessment questionnaires and should be considered both as a diagnostic tool, and as a tool to assist in regulatory understanding of the marketplace.

We would caution against excessive or unnecessary use of questionnaires, as this would, in effect create a new burden on the marketplace.

We would also note that, once the risk management framework and internal controls of a company are determined to be adequate for market conduct purposes following such a questionnaire, we would expect that future self-evaluations would not be undertaken unless absolutely necessary. This is an important result which stems from applying a risk-based approach, namely, that well-managed market participants are assessed only periodically or when some specific risk is identified. Additional comment about self-assessments and privilege is provided below.



6. **Co-operation**

The paper suggests that industry-regulator cooperation and information sharing are key to a solid understanding of risks and market developments.

We agree with this observation, and would suggest that some structure, such as a CCIR-industry working group, be established to further collective understanding of a risk-based market conduct framework and to foster increased communication on an ongoing basis.

Privilege

Given that industry self-assessments would form a critical component of the diagnostic tools relied upon in a risk-based framework, it is essential that compliance self-evaluative privilege be incorporated into the framework. In its December 2005 "*Discussion Paper on Privilege and Whistle-Blower Protection*", CCIR had noted, "Regulators do not want the litigation process to adversely affect public protection through a risk-based regulatory system. Privilege is intended to promote the effective and economical use of self-assessments as part of a risk-based system of regulation."

While CCIR recognizes the importance of this legislated privilege, few jurisdictions have, as yet, moved to incorporate it into their legislation. We urge that CCIR reinforce the importance of having legislative provisions in place in all CCIR jurisdictions as soon as possible.

Role of Industry Standards

The life and health insurance industry has been committed to the development of responsible and responsive standards for many decades. We would anticipate that this approach, evidenced by the CLHIA Guidelines, and in continued cooperation and consultation with regulators, will form an important building block to a principles- and risk-based regulatory regime.

Next Steps

This paper is an important first step in moving towards a risk-based regulatory framework. We look forward to participating in any processes that are put in place as you move forward.

We thank you for the opportunity to provide comment. Should you require further information, please do not hesitate to contact me or my colleague Leslie Byrnes directly.

Sincerely,

Original signed by

Frank Swedlove