

July 4, 2005

## **Response to CCIR Consultation Paper**

### *7. Questions for Stakeholders*

*The policy options outlined in the paper are for consultation purposes only. The IPRC welcomes the comments, suggestions and ideas of consumers and insurance industry stakeholders regarding the information, issues and options described in this consultation paper. Please use the questions below to help structure your suggestions and comments. The IPRC also welcomes additional questions or comments.*

I respond to this as a consumer. I am responsible for the annual purchase of insurance having premiums of approximately \$3,000,000.

I am completely in favour of criminal charges for criminal actions. I am not in favour of a Canadian version of the apparent over-reaction that seems to be taking place in the USA, where there is a completely different regulatory environment than we enjoy in Canada. Here, we apply some reasonable controls on who can be in the insurance business and then we can have a reasonable, principles-based regulatory environment. In the “land of opportunity” to the south, it seems that anybody can get into the business but then there must be a comprehensive, prescriptive regulatory environment to identify and deal with offenders.

### *Policy Options*

*1. How do the policy options affect you (consumer, intermediary or insurer)? Do the policy options alter current intermediary relationships with insurers and consumers/clients respectively, and if so, how?*

Codifying the concept that the customer’s interests are primary cannot be a bad thing.

Codifying restrictions will not help me. I think it would only increase my costs. (See comments in point 2, below).

Enhancing transparency on each transaction will not help me. My broker service agreement already requires disclosure of all commissions of any kind that are identifiably linked to business placed on my behalf.

*2. How would the policy options affect the existing methods of insurance distribution?*

Codifying restrictions on performance-linked benefits is not as easy as it first sounds – because performance-linked incentives related to placement and retention of a volume of quality business are good, are customary in most businesses, and will ultimately benefit the majority of consumers, as well as intermediaries and insurers. Where the intermediary does not do any underwriting of the risk, the insurer will need to do more – so it is a question of who does the work, not how to eliminate the cost. Where the consumer cannot present quality business, there is always the risk that that consumer will have difficulty purchasing insurance, or can purchase it only at what is considered by the consumer to be an “unreasonable” cost. Some intermediaries specialize in the placement of high risk business. Some insurers specialize in high risk business, while other insurers specialize in low risk homeowners insurance. The only simple control on this is to have a disclosure requirement applicable to intermediaries that derive a disproportionate percentage of their annual revenues from something other than placing new or renewal business. What appears disproportionate? (Perhaps something greater than 25%) Then, one would have to consider what services are being provided in addition to traditional broking services. Codifying restrictions is a problem in an industry as complex and diversified as the insurance industry.

Enhancing transparency on each transaction has little or no net benefit because of the increase in overhead that will ultimately be paid by consumers. How to disclose, what to disclose, and how to explain what is disclosed will become issues that serve little purpose but will consume time and resources. Consumers know that many, if not most, intermediaries work on a commission basis. The bottom line amount (premium paid) is generally what is important. Where premium volume is large, as in most large commercial accounts, fee-for-service agreements are generally negotiated with brokers. Clients who want full disclosure often require that as a condition in the broker service agreement.

*3. Are the policy options the best means of accomplishing the objectives identified in the consultation paper?*

Considering the millions of transactions dealing with the sale of insurance in what is a pretty competitive environment, perhaps one should expect a few incidents involving dishonest individual agents or broker representatives. License cancellation and/or criminal charges can deal with one aspect. Another aspect can be managed with reasonable fines imposed on corporations that fail to ensure compliance. Civil judgements and/or reimbursement of provable individual damages can complete the necessary remedies. All of these possible remedies

already exist. We should strive for minimal principle-based regulation aimed at preventing the worst abuses. This will ensure a level playing field, regulation that is affordable and responsive – and it should make harmonization easier. Consumers have ample opportunity to seek and get the information when they need to inform themselves. Insurers could do a better job of explaining their product to individual consumers, but individuals often seem not to care until they have a loss.

*4. Have the policy options overlooked any other approaches or considerations? If so, please provide us with an outline of those approaches or considerations.*

Find the least invasive and most principles-based way to regulate, and use the penalties that are currently available when penalties are needed. If restrictions on performance-based benefits for intermediaries seem warranted, then require the intermediary to report the amount of benefits that exceed a specified cap (with the cap being a percentage of revenues for placing and renewing business), and review the reasonableness of the excess. A penalty equal to the amount of the excess would bring a quick halt to the practice. Suspension of a business authorization might be a reasonable penalty for failing to accurately report.

*5. As a consumer/client do you feel your interests will be better protected by some or all of the policy options? Which policy options do you believe would offer the most value in making your insurance purchasing decisions?*

Codification of the priority of the client's interest does make sense, but even that will make little difference to me. The other two possible policy options will provide little, if any, benefit to me, but will surely increase my cost as the regulatory loading gets added to the cost of the product.

*6. Are there any regional issues or considerations such as different distribution channels that have not been adequately considered?*

If insurers relying on brokers must disclose commissions paid to intermediaries for placing and renewing insurance policies, then it is only reasonable that direct writing insurers and insurers using exclusive agents be required to disclose their costs to acquire business – whether paid in salary, salary plus incentive bonus, or some other form of commission.

*Scope and Applicability*

*7. This consultation paper proposes two potential approaches for determining the scope and applicability of the policy options. Do you have a suggested approach for determining the scope and applicability of the policy options?*

Perhaps the word “Independent” should be scrapped. As the paper states, it is hard to be truly independent when there are investments by or loans from any insurer. Eliminating the use of “independent” will eliminate much of the consumer perception that the entity or person is truly independent. The word “broker” should be used for those having agency contracts with more than one insurer. Perhaps “Exclusive Agent” should be used for those having an agency contract with only one insurer.

*8. Should some or all of the policy options apply only to intermediaries that hold themselves out as independent, or should they apply to all intermediaries?*

Prohibit the use of the word “independent” unless: there are no ties to any insurer as a result of loans, investments or exclusive contracts. Concerns about conflict of interest are valid with respect to any agent or broker who uses the word “independent” to describe his/her role as an intermediary.

*9. Do you have any suggestions for describing or interpreting independence?*

The paper covers the territory fairly well.

*10. Some intermediaries provide additional services to insurers or to consumers on behalf of insurers. Are there any services provided by intermediaries that may create conflicts of interest or potential conflicts of interest? If so, do you have any suggestions to address such conflicts?*

There are many services that intermediaries might provide, where there is potential for accusations of conflict of interest. Intermediaries may present the facts concerning the risk in the best light from the consumer’s point of view, in order to negotiate the best price for the consumer. Loss prevention advice will benefit both the insurer and the insured – but the consumer may want the least-cost recommendation or may wish to set priorities based on the consumer’s needs. If claims services are provided, is the purpose to minimize insurer losses or to maximize policyholder recovery. The intermediary is always in the middle. The job is to manage the conflicting interests in a way that both insurer and insured are content with the result.

*Performance-Linked Benefits Provided by Insurers to Intermediaries*

*11. Is the concept of performance-linked benefits sufficiently clear?*

Yes.

*12. Should performance-linked benefits be regulated, and if so, how?*

It seems that at least one very large broker was in a position to use its market share as leverage when negotiating with insurers, and was able to get performance-linked commissions that, on the surface, appear excessive. Having to report revenues that exceed a cap (as outlined in point 2 above), might be a reasonable requirement. It might be reasonable to prohibit Canadian-regulated insurers from paying portfolio-based commissions that exceed a stated percentage of premium income. Beyond that, it is difficult to control without spending unreasonable amounts of time and money.

*13. Should the restrictions on performance-linked benefits be absolute or limited by introducing appropriate controls and qualifications (e.g. setting a maximum dollar amount)?*

A dollar amount would be unmanageable. A cap that is a percentage of the premium earned on a portfolio of business is probably workable. (See point 2 above).

*14. In determining what constitutes a performance-linked benefit, should the relevant rules be principle-based or compliance-based?*

If a percentage cap is chosen, rules can be compliance-based. I believe any other type of compliance-based rules will produce unreasonable amounts of compliance overhead that will ultimately have to be passed on to consumers and be seen by those consumers as an unnecessary regulatory burden.

*15. Some insurers offer services or assistance to intermediaries (e.g. office space). While these services or assistance may not be linked to a specific performance target, some may argue that they create a potential conflict of interest. Do you agree that regulatory measures need to be introduced to address this potential conflict of interest?*

No – but see comments regarding “independence” in point 8 above.

*Disclosure*

*16. The disclosure option provides for differing levels of detail, timing and methods of disclosure. As an intermediary or insurer, do you anticipate any difficulties in complying with this option? As a consumer/client does this option provide information on intermediary relationships with insurers that is meaningful and useful for an insurance purchase?*

As a consumer, no. I don't care about the non-criminal relationships between intermediaries and insurers. What is meaningful is a high level of trust between my broker and I, and a broker service agreement that spells out what we expect of each other. With respect to my personal homeowners and auto insurance, I evaluate the insurer, the agent or broker and the price. Receiving additional disclosure from either broker or insurer would not be useful to me.

*17. Is the scope of the disclosure option broad enough to provide consumers/clients with sufficient information to make informed purchase decisions? If not, what else should be included? Do you have any suggestions as to how this disclosure option could be structured so that it would be easier to understand?*

Where the insurer holds a significant percentage of the issued shares of a broker or vice versa, I believe this should be disclosed. Where an insurer has loaned to the broker a significant sum that exceeds a stated percentage of the annual net commission revenue of the broker, I believe that should be disclosed. Perhaps 20% or 25% would be an appropriate cap above which disclosure will be required. Let's keep it simple. I do not need to know what commission was paid for placing the business.

*18. As an intermediary or insurer, do you anticipate any difficulties disclosing the quantum of any commissions and service fees associated with the specific transaction, excluding any contingent commissions, expressed in dollars and as a percentage of the premium?*

(Not applicable to me).

*19. Do consumers need to understand how an intermediary is paid for his/her services (e.g. contingent commissions and bonuses) and how much in financial terms the intermediary earns from the sale of a policy to a consumer? Is it relevant information for the consumer?*

Not generally relevant to an individual consumer, in my opinion. As outlined in point 2 above, I believe regulators might become concerned when contingent commissions exceeds a percentage cap, in relation to revenue for placing or renewing business.

*20. Are there any innovative methods of satisfying disclosure requirements that you can provide that have not been considered in this consultation paper?*

See point 2 above.

*21. Are there any alternatives to disclosure that regulators should consider?*

Move away from disclosure of specific transaction-related commissions because such disclosure will produce little benefit and clearly, will cost time and money to disclose and explain. Consider capping contingent portfolio-based commissions at a reasonable percentage of commissions paid by an insurer to brokers or agents for actually placing individual policies. (This could be “policed” by requiring insurers to report payments exceeding a percentage cap, and by requiring brokers and agencies to report such revenue that exceeds a cap). Require disclosure of significant loans between insurers and broker or agency companies and of significant investments by insurers in broker or agency companies, or vice versa.

*22. Should all L&H products be subject to the same requirements or are there situations where exemptions should be permitted?*

As much of the L&H business is sold by persons receiving commissions or some volume-based salary and bonus structure and as there are likely many more individual exclusive agents than in the P&C business, the amount of required detailed disclosure on a policy-by-policy basis is more problematic than for the P&C business. However, if the concept of a reasonable cap is implemented, the process of disclosure should not become demanding for either the insurer or the broker/agent. Disclosure of significant loans or investments should be disclosed. What is “significant” becomes the issue.

*23. Are the policy options cost-effective and enforceable?*

No. Only a cap of some reasonably large percentage will result in a cost-effective policy option. The cap must be set at a threshold above which reasonable people would think “exploitation” and “harm” is occurring.

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