

Comments on

## **CCIR & CISRO Industry Practices Review Committee**

### **RELATIONSHIPS BETWEEN INSURERS AND SALES INTERMEDIARIES CONSULTATION PAPER, June 3, 2005**

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In 2004 a committee of CCIR and CISRO was formed “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 resulting report states “No evidence of any illegal insurance related activity was found” but that “some current business practices may contribute to a perception of or actual conflicts of interest in the marketplace.... This may have a negative impact on consumer confidence in the insurance marketplace.”

“This consultation paper outlines a range of possible policy options which the IPRC (Industry Practices Review Committee) 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 Life & Health insurance sectors, unless there are obvious and compelling reasons to establish separate standards.

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.”

Commentary:

I have been in the financial services industry as a licensed agent/representative for over 30 years. I have been a mutual fund representative, a life insurance agent and a P&C agency owner. My first submission/commentary was in 1975 and I have made many more since then.

This CCIR paper does not adequately reflect the significant differences in the three industries – life insurance, P & C and mutual funds.

The mutual fund industry banned performance based compensation – free exotic conferences to reps who recommended the sponsor's funds. The problems faced by regulators that lead to NI 81-105 were different than the problem suggested in this paper – the perception that there might be a conflict of interest.

The P & C industry is totally different than the life and funds industry and the notion that regulation should be similar is dangerous. For example, switching mutual funds from one company to another can be done without cost or penalty, and perhaps only to meet a convention sales quota. In the L&H industry disability insurance is difficult to switch and life switches are extensively covered by replacement regulation. In the P & C business a broker is very fortunate if he has more than two carriers to choose from for a given class of business. The business is re-written with a new policy every year. That is, there is an opportunity to switch policies or companies every year. In Ontario, the broker is already required to show the client the lowest price plan he has available.

After an extensive review of both the P & C insurance industry and the Life and Health industry, “No evidence of any illegal insurance related activity was found”. That suggests there is no problem begging for a nation-wide solution. “If it ain’t broke – don’t fix it.”

Instead, we are presented three options for regulatory change. Logic suggests that the first option should have been “Do nothing.”

#### Option 1

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

It is shocking to contemplate that this requirement does not already exist in all jurisdictions. Yes, this is a good idea. However, this requirement is usually #1 in a Code of Conduct. Why is that we have 60,000 or so life insurance agents in Canada who are not all regulated by regulators equipped with a comprehensive Code of Conduct? If the object of regulation is public protection, a common Code of Conduct in all jurisdictions would better equip regulators to protect consumers.

It is not that regulators have not drafted the Codes. Some of the western councils have codes but the provisions have not all been adopted by regulation, so they are not enforceable. In the mid ‘90s the Ontario Insurance Commission worked closely with industry to develop a 29-point Agent Code of Conduct. When it was published in 1995, the announcement said it would be adopted into regulation. It never was. CLHIA objected to a requirement that agents disclose proposed policy benefits, costs and risks to the consumer.

This proposal that all provinces adopt a regulation that consumers interests are to be put first suggests to the public and the governments that this regulation is a priority and worth all the effort required to get something passed into law. The effort to pass one provision of a Code and the effort to pass the entire Code is about the same – so why not have all jurisdictions adopt a complete Code?

If CCIR consulted consumers and industry, looking for a list of problems worthy of regulatory attention, I am confident that Option 1 would be very low on a list of priorities.

Option 1 looks more like window dressing intended to impress consumers and governments that the insurance regulators are doing something.

#### Option 2

“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).”

The stated reason for this intervention is “a perception may exist that independent intermediaries could steer consumers to, or away from, specific insurers in order to achieve certain performance targets or to qualify for benefits. This may have a negative impact on consumer confidence in the insurance marketplace.”

Recruiting, training, retaining and motivating life insurance agents is a major challenge. According to the report virtually all life insurance companies are involved with performance linked rewards and motivation schemes and no evidence of abuse was found. Most insurers and insurance distributors also have a performance linked quota to keep the relationship. That is, produce business or you are terminated. Personally, I have had my contract cancelled with several companies because I did not produce enough business to justify the contract or because the company was happy with the business I gave them but unhappy with how much business I directed to other insurers.

My commission on a sale is typically in the thousands of dollars. My commission could be increased or decreased by 50% depending on which type of product I chose to recommend. To suggest that such a potential conflict of interest is “normal business” but a further bonus of less than \$100 credit towards a Hawaiian conference could cause me to steer consumers to a particular company or product is ludicrous.

If I was going to regulate potential client abuse due to performance linked compensation, I would be more concerned with the practice of firing agents who do not meet sales quotas. These agents are under far more pressure to produce for a single insurer than an agent who might qualify for a conference. But industry would argue that the right to fire an unproductive sales person is standard practice. And I would argue that the right to motivate and reward a productive sales person is also standard practice.

I note that insurance company executives receive performance bonuses. I note that government (regulatory) staff in some provinces receive performance bonuses. Why is it that the agents licensed by these same regulators and hired by these same executives are deemed untrustworthy of receiving performance bonuses? Are licensing and supervisory standards too low?

Regulators should be very wary of heavy-handed regulation of business practice – especially if the only reason is that “there might be a perception of a conflict of interest.” The immediate result of a ban of performance-linked benefits might only be a cost savings to insurers. Is this the purpose of the proposed regulation – to add to life company bottom lines? Are the insurers lobbying regulators to end a sales practice that companies are unwilling to end voluntarily?

It could backfire. If performance linked benefits have not been effective, the result would be more profits. If they were effective (and one can wonder why they are universally used if they have not been effective) then the result could be reduced sales and lower profits.

The social costs of meddling should be considered. I have read that the average Canadian family only has \$165,000 of life insurance. This inadequacy imposes huge social costs

on society. Society would be much better off if each family purchased an additional \$500,000 of term life insurance. That would require motivated sales agents.

In the UK, regulators attempted to help consumers by restricting the maximum commission on savings products to 1%. After ten years they have discovered that the sale of savings products by the life insurance industry has just about disappeared and the national savings rate is now a fraction of what it used to be.

I suggest that incentives that promote additional sales of life insurance are, on balance, in the public interest.

This proposal is too dangerous to consider.

### Option 3

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

The Ontario Code of Conduct addresses conflicts of interests. Regulation 347 requires disclosure of all companies and services represented. The Code was not passed into Regulation and the Regulation 347 is universally ignored and perhaps unenforceable.

Option 3 appears to be a solution looking for a problem. In 30+ years of practice I have never been asked about my commission, except on rare occasions when consumers were concerned if I was being compensated for my efforts. No consumer has ever expressed any interest in the level of my compensation.

If actual percentages or dollar amounts were disclosed, the disclosure would harm consumers. Consumers are interested in getting the best value for their dollar. Their focus should be on premiums and benefits. Providing compensation data would muddy the water and lead to poor consumer choices. If I disclose that I receive a commission of 90% and another agent discloses he receives 40%, the consumer may conclude that the other agent must provide better value for the dollar. The fact might be that we offer the identical product, but I have 30 years experience and sell a lot of that product, whereas as he is a new agent with a poor sales record.

Life insurance is distributed through a system. There is no relationship between consumer value and my compensation. My access to some companies is through a long chain whereas access to others is direct. I know how much I receive but have no idea how much is paid to those above me in the chain. Even disclosure of total compensation loading in an insurance product (like disclosing a 3% MER in a mutual fund) is of limited value because there are so many other variables that go into pricing. A product with a low compensation that also assumes a low future interest rate could be a much poorer deal to the consumer.

I find it difficult to consider the merits of disclosing agent compensation when most provinces have no regulation requiring full disclosure of costs, benefits and risks of proposed insurance products. I suggest that issue be considered a priority.

If there is to be a proposal that all jurisdictions should adopt a similar regulation, then why has CCIR not conducted a consultation to find a consensus on the priorities? Such a consultation was undertaken in 1999 by CCIR. I participated in that process, representing independent life insurance brokers. I recall we addressed the need for life insurance policies to contain a definition page, to define the meanings of such provisions as “non-smoker”. I recall we agreed on a minimum standard of E & O insurance for all provinces. This consensus of issues, priorities and solutions has been ignored in this paper. In fact, so far as I can see, it has been ignored by everyone.

Every regulatory initiative has a cost. In addition to the cost of enforcement and compliance, there is the opportunity cost. Regulators have very few opportunities to get new regulations passed. Why squander such an opportunity on a regulation putting client interests first or compensation disclosure? What a wasted opportunity!

In conclusion, I suggest regulators set priorities for new regulations. The priorities should consider the issues of existing and real consumer abuse and the cost–benefit of any proposals.

I sometimes work with lawyers as an expert witness. I see consumers suing insurers for their benefits. In my opinion the single biggest problem deserving regulatory action is a re-draft of the “change of insurability” provision of the Insurance Act of the common-law provinces. This provision is used to deny benefits on life policies that have been thought to have been in force for years. I suggest that denied insurance benefits could have “a negative impact on consumer confidence in the insurance marketplace” more worthy of regulatory attention than a Hawaiian conference.

The wording is too vague and the provision is unnecessary. It reads: **“Subject to any provision to the contrary in the application or the policy, a contract does not take effect unless no change has taken place in the insurability of the life to be insured between the time the application was completed and the time the policy was delivered.”**

There is no requirement that the “change” be a material change or even a negative change in insurability. There is no requirement that the change be known to and understood by the life insured. If an insurer believes this wording is necessary, it can be placed in the policy contract, where agents and consumers can see it.

I note that a similar law does not exist in the USA.

In my opinion, the proposals in this paper are not priority issues within the industry and would squander an opportunity to deal with the real problems.