

A submission in response to the CCIR & CISRO Relationships between Insurers and Sales Intermediaries Consultation Paper of June 3, 2005.

A General Overview of the Document and the reasons for this debate:

It is rare to find a document produced for philosophical discussion that makes so many assumptions towards an apparent foregone conclusion. I am perplexed by the manner in which the authors of this report seem to assume their presumptions will be welcomed by an industry they presume in need of reigning in and a public they presume in dire need of protection from unfair practices. For the most part I believe that the general public will take little interest in this discussion. For the most part, **as the report itself concludes before it begins, there has not been found any evidence of unfair practices driven by compensation issues in the insurance industry in Canada** and there has been very little made of the issue outside of debate within the industry and between the industry and the regulators. To this reviewer it appears that there is some bias in this consultation paper that presumes that certain industry compensation practices may be perceived as unfair and that action must be taken to correct this. It would seem to me that the whole of the report turns on this perception and accordingly in review of this paper one is prompted to come to an unfair conclusion.

Apparently the initial scope of the review for which this consultation paper was made was to determine if unfair and illegal practices undertaken by some insurers and brokers in the United States were in fact found to be being used by some in Canada. One should be reminded that what occurred in the United States was an illegal activity not specifically related to the delivery of insurance products, but in the forum of bid rigging, price fixing and kick backs that would not be agreeable, ethical or legal in any market sector. Much was made by the regulator involved in the American incident in his media reports regarding secret commissions and contingencies that were structured to the benefit of the broker and insurers and to the detriment of the customers. This resulted in a media attack on the insurance industry's compensation practices and the issue of those practices has become a reason for debate, particularly amongst the regulators of the insurance industry in Canada.

After determining a thorough review of the industry and its compensation practices in Canada the conclusion is made that there is no evidence that such unfair and illegal practices occur in Canada, yet even this conclusion is qualified by the reports authors who assure the readers that they are continuing to try to find some and will act upon it when they do. **One would expect a regulator or group of regulators who completed an evaluation of the industry they were charged to regulate and ensure of fair performance in the market place, would be substantially ecstatic to find it operating the way it should be.** There would also be an expectation that much ado would be made about the great job they were doing and how their study had conclusively proven that the industry was healthy and fairly competing in the market place as a result of their stewardship. We would look for comments of assurance to the public that they have nothing to fear from this industry and that they would be fulfilling that often overlooked role of a regulator, that of instilling consumer confidence in the market it regulates. Strangely though, in the face of such positive news, a very negative document has been produced throwing suspicion upon an industry and its compensation practices. The motive for such is hard to determine and as one engaged in this profession for a number of years I find the document somewhat insulting in its insinuations.

The whole of this discussion seems to have arisen as a result of the media attention in respect to the aforementioned illegal activities in the United States. So far as this writer is aware there have been no documented complaints of unfair industry compensation agreements made to any of the regulators involved with this study in any jurisdiction in Canada. If there have been any number of record, they are not referenced in this discussion document as they should be to support the significance of the need for this review. There have also been no changes in the manner of compensation or any “new” approaches to the issue of compensation that might impact upon the market place and the consumer. These compensation practices under review have been in place for decades some for as long as the insurance business has existed and there have been no previous issues of concern that they are unfair or biased and operate to the detriment of the consumer in all that time. These compensation agreements form the part and parcel of thousands of business contracts between insurance brokers, insurance companies, Direct Writer salaried general agents, sub brokers and virtually anyone selling the P&C and L&H insurance product in Canada. In their generality they are a valuable part of the competitive process between sales agents and their suppliers and through that produce a competitively driven market where the savings provided by such competition are reflected in the final price of the product to the consumer. It needs to be stated that the interference in this market place by regulators as defined in the options placed for discussion in this paper, will produce additional costs and restrict competition. The consumer will not benefit from increased costs that will be passed onto them, nor from the lower number of choices that will result from such restricted competition.

I've chosen to limit my response to the three questions arising from the executive summary regarding policy options in the consultation paper. As I've concluded that the need for any action whatsoever is redundant, answering the questions in regard to the implementation of the discussed policy options makes little sense. Suffice to say that in this writer's opinion there are no positive outcomes in the implementation of this policy for either the industry or the consumer.

(1) Codifying the Public Interests.

It is offensive to me that there is a perception that people engaged in the development and delivery of insurance products to the consumer need to be regulated to put the needs of their customers ahead of their own. It would seem apparent to anyone in any competitive environment that businesses who fail to conduct themselves properly in their marketplace do not succeed for very long. Our business is already highly regulated and quite difficult to get into. The practitioner must pass an examination, move through various levels of professional development and licensing each accompanied with regulated levels of supervision, they must maintain a professional level of education and training and stand before their peers if found in violation of the myriad of regulations they are already bound by and the ethical considerations of them.

I am proud of the profession that I have chosen and in the way it operates. By my own involvement in the regulatory process for over 4 years, I've seen virtually every conceivable violation of the trust the consumer puts in the individual working for them and even so, the number of such incidents is so infinitesimally small in relation to the number of transactions that occur that it is hardly worth calculating. There will always be people who violate the public trust and there already exists much legislation and regulation to deal with these people as it does adequately already. Individuals found in violation of the existing statutes are dealt with by penalties and suspensions that are to the extreme in comparison with other industries. The industry in Alberta is for the most part regulated by its peers, which demonstrates the test of professionalism for the practice of sales of this product and service. The evidence of that regulation supports the notion that the system is presently working well and in no immediate need of adjustment.

I will submit that the current regulations in Alberta and similar legislation in other jurisdictions adequately codifies the Publics Interests. A review of the Insurance Act in Alberta, RSA 2000, Chapter 1-3, Part 4, Market Conduct, Sections 499 through 511 will lead anyone to this logical conclusion. In example the following statute is quoted:

RSA 2000, Chapter 1-3 Section 509

- (1) No insurer, insurance agent or adjuster may
 - (a) make a false or misleading statement representation or advertisement,
 - (b) engage in tied selling practice prohibited by the regulations
 - (c) commit any unfair, coercive or deceptive practice, or
 - (d) make any statement or representation or commit any practice or act that is prohibited by the regulations.
- (2) No person may, by means of misleading or false statements procure or induce or attempt to procure or induce any person to forfeit, surrender or allow the lapse of any policy of insurance.

A profession approach by members of the insurance industry already exists along with associations dedicated to the professional delivery of the products and services and a peer driven independent quasi judicial body enforcing proper market conduct. There is no evidence of a need for further interference in this market place and the codification of Client's interests are well entrenched in existing legislation and regulation already.

(2) Restrict Performance-Linked Benefits Offered to Intermediaries

The components that form the ultimate price of any product consumed include a number of common factors. The insurance product is no different. There is a component relating to the cost of the pure product, one relating to the cost of delivering it and one relating to the return on investment expected in competing in the custom. The essence of the capitalist economic model all revolves around the competition in all these components, which, according to the proven theory of competition results in the best possible price received by the consumer. The only time there is a deviation of this truth is where the number of competitors is such that competition is stifled by a follow the leader approach or where through government regulation a base line removes the competitive factors. I think there can be no doubt that the insurance industry in Canada is extremely competitive in every instance. There are well over a hundred companies competing in the P&C business in most Provinces and in all sectors, excluding automobile in the Government Auto Provinces and the Personal Lines business in Quebec where the regulatory environment has stifled the number of companies willing to compete there.

Every business operating in Canada remunerates on a performance linked benefit basis. Distributors of all kinds of goods provide cost reductions for volume purchasers along with bonuses for product promotion and display placement. Auto dealers compete against other auto dealers based on their sales achievements, even within their own brand name products. All kinds of manufacturers reward their distributors on the basis of volume of sales. I cannot think of any product that is offered for sale that doesn't come with some volume discounts or incentives for its successful distribution. There is no evidence anywhere I am aware of that these incentives operate to the detriment of the consumer. In fact there is considerable evidence that these reduced prices are passed onto the consumer through product promotions, loss leading for market share and discounts resulting in an advantage to the consumer. Performance-Linked benefits form an essential part of the competitive model which will always produce the best possible result for the consumer.

As noted in the discussion paper contingent commissions come in two forms, one is based upon volume increases and the other is based upon the claims results and profitability. Any insurance executive will confirm to you that they have never put a successful marketing program together without being competitive in price first. Paying additional commissions won't win you market share. There are simply too many options for the consumer for anyone to influence the market place at the distributor level through the payment of higher commissions or bonuses based upon volume. In Alberta in 2004 there were roughly 6,600 Life Insurance brokers and agents working for over 1,400 Designated Representatives representing managing general agents, insurance brokers, and direct writing companies. In the P&C business in Alberta in 2004 there were over 5,600 General Insurance brokers and agents working for 800 Designated Representatives representing Insurance Brokerages and Direct Writing companies. It is a given that in a production based business each of these license holders compete in the market place, even with others working for the same sponsoring company. To suggest that an unfair advantage within the market place could be created through Performance-Linked benefits offered by any one company is simply absurd. The competitive dynamics should be apparent to anyone.

In the second instance contingent commissions are based upon profitability of an insurance book of business which is driven by loss experience. This form of remuneration is only associated with the P&C part of the business. It is simply a form of profit sharing which is calculated on the basis of the sales intermediary's success in selecting the best risks for the company as determined by the company's actuaries. This isn't done on the basis of the placement of insurance in the form of priority for each customer. In fact it comes about through properly matching the underwriting restrictions of the insurance company with the qualifications of the customer. When done correctly it will produce the best price and the best product for the customer and the best risk for the insuring company. This is driven by actuarial assumptions, which should properly be reflected by the

underwriting restrictions for the classes of risk (customer) selected. The better the job done, the better the returns for all parties as in a competitive environment the class of insurance customer that has the fewest losses will be competed for the most and will ultimately receive the best possible price. Stifling the competition for these good insurance customers by restricting the benefits that can be offered in selecting them will produce an adverse result for the consumer. No one will receive a preferred rating as all the insurance risks will be reduced to their mediocre value from an underwriting and actuarial perspective. The incentive for the broker or agent to do the best possible job to match his customer to the best possible rate in the market will be removed as well.

It should be noted that contingent profit sharing is always subject to a large group of customers and is not driven by the specific considerations of any individual customer. It should also be noted that local catastrophes such as hail storms will wipe out all the actuarial assumptions in these programs and the payment of a contingent commission is by no means a certainty for which the agent broker can take proactive action to achieve. It is well known in the industry that in some locations achieving a contingent profit commission cheque is almost as likely as winning the lottery, no matter how well the broker or agent does the job.

The last word on this subject is such that this form of compensation in the P&C business has been in use since this business began. The recognition that the agent/broker is an essential part of the underwriting process and the reward for the success of this process forms part of any contract between a broker/agent and his company's or company. It is in common usage in every country where P&C business is conducted and in its general use bears no resemblance to the process of abuse conducted in the United States and referenced in by the regulatory body there.

(3) Enhance Transparency of Compensation, Ownership and other Financial Interests.

Many people reading this consultation paper are somewhat at a loss at the bundling of the issues in the L&H business with those of the P&C business. The two facets of the insurance business bear little resemblance to each other when comparing the compensation arrangements and delivery models. It is my opinion that the complexity of remuneration agreements in the L&H business are such that no useful service will be accomplished through revealing the compensation in a Life insurance policy sale. To fully disclose all the agreements would place the entire delivery model of L&H business into jeopardy. Revealing the specific arrangements between Insurance Company's, their Managing General Agents and their sponsored producers would simply cause chaos within the industry and serve no useful purpose to the customer. In effect, the simple fact that the agent has an interest in the outcome of the sale is apparent to anyone and is there really a need for any further notice. The ethical responsibility to ensure the interests of the customer come first in the sales transaction notwithstanding,

does anyone assume that the salesman responding to their needs is working altruistically? Others far more qualified and involved in the L&H business may well wish to add substantially to this topic from their interest and perspective. My main involvement in the industry is on the P&C side of things and I will restrict my further comments to this consultation paper and its questions from that perspective.

Generally speaking in the P&C business there are three parts to the intermediary incentive model that the consultation paper feels a need for disclosure and transparency on.

1. Commissions of any nature.
2. Loans from Insurers to sales intermediaries.
3. Share ownership and interest in a sales intermediary by an insurer.

As we know, parts of the P&C industry have already moved to increase the level of transparency in disclosure to the public of the compensation arrangements in place on the product they are purchasing. In Ontario a disclosure form has been agreed to by the insurance brokers that summarizes the averages and fully recognizes all forms of benefits received from the insurance company the business is placed with by a broker. By an agreement with the Superintendent of Financial Institutions in Ontario this was done even retroactively with a full scale mail out of the disclosure notice to all customers by the brokers. To this end, in a recent discussion of the mailing out of these notices with an Ontario Broker to over 26,000 customers it was noted that in not one instance has there been a call to any of their offices in regard to the letter sent to them. As I have been often noted to state, decisions made in Ontario are not by that nature necessarily correct. As a businessman I can comprehend the cost of mailing 26,000 pieces of correspondence and would normally look for some kind of return on an investment like this. To this end there is no justification for this as in my opinion the market place has no interest in the issue. Of course the costs of this are unrecoverable and draw against past revenues already earned and accounted for, yet we find in the consultation paper a flippant attitude towards the increased costs and the burden of them in regard to a discussion about this notice. We have also seen a direct writing P&C company move to disclosure of the compensation of their agent on the declaration page of their insurance policies, and initial reports are the customers do not seem to show much interest in the matter. So the question that needs to be asked before the discussion of transparency and disclosure is what is the issue here?

In General terms, we have no objection to revealing the remuneration we receive on the products we sell. In fact, for the most part if the consumer is interested all they need to do is ask. The information about commission rates, contingent bonuses and ownership of the brokerage are not considered a secret in the trade. There is a limit in this regard though where the disclosure of these things may well violate private agreements and the right to privacy in them. I remain of

the opinion that competitive pressure will never allow a compensation agreement to severely impact upon the insurance consumer. The many choices available to the consumer, especially in regard to personal lines business are such that the issue of how much money the seller is making is of much less concern than how much money they have to pay. The yellow pages are full of options to explore and any insurer or broker or agent who attempted to extract a competitive opportunity from the market place would find themselves quickly heeled by others wishing to exploit the same opportunities.

We've discussed somewhat the terms of agreements between the Brokerage or Direct Writing Managing Agent but what about the other agreements in place? In general terms many agents and brokers work in a level below that of their sponsoring agent. The splits of commissions between a Broker principle and a sub-Broker are a competitive factor between employers in competition for the sub-broker. An employer Broker may well lend an employee/agent money for one thing or another is this to be disclosed to the consumer as well? Will one employee broker or agent have to have his negotiated arrangement within the brokerage or agency disclosed to all the others that work there?

In specific regard to loan agreements between insurers and intermediaries or even between the intermediary and their employees or sub-brokers, these facilities remain important to the industry. Contrary to the perception glossed over within the consultation paper that they exist for the most part to provide funds to "purchase other intermediaries" in fact more often than not they provide a source of funds for succession of the business to another member of the family. This is evident with both Brokers and Direct Writer Agents as well. As to the successful growth of any business, often a source of additional funds for expansion or even the purchase of another business is necessary. The goodwill nature of the insurance business does not lend itself well to the collateral requirements of Canada's banks. Nor are their many other lenders interested in funding the insurance business. It is of considerable concern to those of us in this business that the implementation of disclosure requirements proposed in regard to these loans may well make it more difficult to arrange needed financing. This could have extremely negative impact upon the industry. Intermediary Companies unable to obtain financing for their operations would be unable to expand and take advantage of competitive opportunities or sell their businesses for a fair price. The lack of available financing would impact negatively on the value of these businesses as well and people who have invested their life's work in building a going concern that they could sell to sustain them in their retirement may find themselves disadvantaged.

I think in this regard we find that disclosure becomes an issue especially where it impacts upon proprietary arrangements between suppliers and distributors at whatever level they may compete at. The insurer who has entered into an agreement with a broker for higher commissions and contingencies on account the commitment that broker has made to providing additional levels of service to the insurer may well not wish to have the contents of that agreement known to other brokers it sponsors. Here there may well be a value added reason for a different compensation arrangement that provides a competitive advantage over a competitor insurance company. This arrangement revealed by a disclosure requirement will no doubt remove the competitive advantage. Do we really want to impact the market place through regulation that restricts fair competition?

The requirement to disclose margins of return is not practiced in any other business. It is not expected by the buying public nor demanded of the insurance industry as some regulators have concluded. These issues of transparency that are bandied about within this consultation paper as in dire need of implementation for the public good were once considered proprietary and sacrosanct. The motivation to regulate their implementation is difficult to understand.

Having said all this on this issue, the provision of disclosure of the differences between what an insurer charges and a broker/agent receives is not so distasteful that it is to be rejected out of hand, even if the need is not apparent.

As to the ownership of a sales intermediary, the conclusion that ownership of the sales intermediary results in unfair product promotion is made with no supporting facts, just biased assumptions. Has anyone considered the fact that a brokerage with total or partial ownership by an insurer is still a brokerage placing business with many different insurers? Is it not apparent that if that brokerage firm was found selecting against any of its markets in favour of its owners it would soon lose those contracts with the other insurers? These assumptions put forth in the consultation paper reflect a complete lack of understanding of the competitive process in the P&C business and the role of the brokerage firm in that process. As to the actual ownership of any business, this information is readily available to the general public. The share structure and ownership of a corporation is easily found at the nearest provincial corporate registry and is not restricted from anyone who desires it. To what purpose does it serve to have it revealed to every client?

In Summary:

This consultation paper makes much of the need for additional regulation and interferences in the insurance market place to protect the interests of the consumer, but provides no evidence of the need. The conclusion is put forth in the document that there is no ethical component to the role that the intermediary plays in the delivery of insurance products and services in Canada yet provides no evidence to support this conclusion other than the stated opinion based upon the perception of the author(s). **The inference that the delivery of insurance products to the Canadian buying public is detrimentally influenced by compensation agreements, the provision of loans and share ownership of sales intermediaries is made but not supported by any evidence of such.**

It is this writer's opinion that the industry in Canada has been serving the insurance market place in Canada very well. The evidence of the ethical behaviour by sales intermediaries in Canada is overwhelming when the statistics of complaints, investigations and convictions are reviewed. The industry is well regulated and the public is well served by the existing regulations. Any concerns about the industry arising out of the events that were discovered by the Spitzer inquiry do not arise from the manner in which the business compensates sales intermediaries, owns or finances them. The illegal activity that occurred in America was a crime that would not have been prevented by any additional regulation on the business. Criminals don't follow the rules. Conspiracy, bid rigging and kick backs are already illegal, transparency and other matters' not withstanding it's doubtful that anyone participating in such schemes would disclose them in any event.

I will close with a variation of the first question asked in the Executive Summary of the consultation paper:

What is the issue and how is it of concern to Canadians?

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