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Insurance Brokers Association of Manitoba (IBAM) Response to CCIR/CISRO Consultation Paper of June 3, 2005

Industry Practices Review

Relationship between Insurance and Sales Intermediaries

July 2005

RELATIONSHIP BETWEEN CLIENT AND BROKER

“The matchmaking or “market making” role through which buyers are matched with insurers is a complex, multidimensional process. The role of the intermediary is to scan the market, match buyers with insurers who have the skill, capacity, risk appetite, and financial strength to underwrite the risk, and then help their client select from competing offers. Also important are the breadth of coverage offered by competing insurers, the risk management services provided, the insurer’s reputation for claims settlement and financial strength, and other factors. It is common for the coverage not to be placed with the low bidder. In the case of very large risks, coverage is likely to be syndicated over many insurers...insurance intermediaries also help their clients understand and measure their risk, advise them on how insurance can alleviate the costs of risk, help design insurance coverage programs, and assist with claims settlements.”¹

The expectations of consumers in Manitoba have been affected by their positive relationship with the Manitoba Public Insurance. Customer satisfaction with the broker force is monitored by MPI on a quarterly basis. Based on these surveys, consumers consistently state that they are pleased with the services provided by the broker force in Manitoba. This expectation for high levels of service is transferred to other property and casualty coverages.

Consumers have not expressed concerns over the issue of compensation for their brokers. The Marsh & McLennan situation has been publicized in the national and local media. Yet there has been no public outcry. Rather there seems to be lack of interest in this issue. Insurance requires a high level of trust and consumers value the services and advice provided by knowledgeable brokers. The public expects that brokers will receive a reasonable level of compensation for their professional services.

In addition the high level of competition in the insurance industry allows consumers to change brokers if they are dissatisfied with advice or service. Customer service has become the focus of professionalism. It is the subject of insurance texts such as the *Customer Service for the Insurance Professional* series or included as a specific section in texts such as the *AutoBroker Technical Course Volume I*.

Brokers live in the community they serve and are an integral part of the daily life. Brokers put clients first because their insureds are not simply clients but also family, friends and associates. They see each other in church, at their child’s school, at local sporting events or community events. Brokers take pride in their active participation in community life.

¹ Cummings, J. David and Doherty, Neil A., 2005, “ *The Economics of Insurance Intermediaries*”, Wharton School – University of Pennsylvania, p. 1.

STATUTES AND REGULATIONS AND CODES

Consumer protection falls under provincial jurisdiction and Manitoba, like other provinces has developed strong, enforceable laws to protect its consumers. These are working well providing consumers with a high level of protection.

The following excerpts are from the Insurance Act dealing with the regulation of brokers and insurance sales.

Specific powers and functions

[396.1\(7\)](#) Without limiting the generality of subsections (4) and (5), the Lieutenant Governor in Council may make regulations empowering insurance councils, on any terms and conditions the Lieutenant Governor in Council deems appropriate, to

- (a) collect any fees fixed under subsection (6);
- (b) exercise and perform such powers, functions and duties as are conferred or imposed upon or delegated to the insurance councils under this section;
- (c) establish the educational, training and other standards and qualifications required for the licensing or registration of agents;
- (d) establish and enforce ethical, operational and trade practices for agents;
- (e) investigate complaints and adjudicate or mediate disputes respecting services provided by any agent;
- (f) initiate and engage in programs of consumer protection;
- (g) make recommendations to the minister;
- (h) make rules for its own procedure;

and may make regulations respecting any other matter or thing relating to insurance councils that the Lieutenant Governor in Council deems necessary.

Disciplinary actions by the superintendent

[375\(1.1\)](#) For the purposes of subsection (1), the superintendent may do one or more of the following after giving a notice of decision in writing to the licence holder or former licence holder:

- (a) suspend the licence of the licence holder;
- (b) revoke the licence of the licence holder
- (c) subject to the regulations, impose a fine on the licence holder or former licence holder and fix a date for the payment of the fine;
- (d) subject to the regulations, require that the licence holder or former licence holder pay some or all of the costs of the investigation and, where applicable, of the hearing and fix a date for the payment of the costs assessed.

In addition licensed brokers must adhere to the following Code of Conduct of the General Insurance Council of Manitoba:

Section 1 – INTERGRITY

AGENTS OR BROKERS SHALL DISCHARGE THEIR DUTIES TO THEIR CLIENTS, MEMBERS OF THE PUBLIC, FELLOW AGENTS OR BROKERS, AND INSURERS WITH INTERGRITY.

COMMENTARY:

Basic Principles

Integrity is a fundamental quality demanded of every insurance agent & broker. If personal integrity is missing, there is little you can do to compensate for its absence or to repair the damage to your reputation. Deliberate wrongdoing and gross neglect are equally reprehensible.

Examples

Examples of conduct which have been found not to meet this requirement include:

Placing yourself in a conflict of interest with your client. (See Section 4 for further information.)

Section 4 – ADVISING CLIENTS

AGENTS OR BROKERS SHALL BE BOTH CANDID AND HONEST WHEN ADVISING CLIENTS.

COMMENTARY:

Scope of Advice

Recommendations to clients shall be complete, open and clear.

You must indicate in detail, the facts and assumptions upon which your recommendations are based. You must study the risk in sufficient detail to provide the client with sufficient information with which to make an informed decision.

Disclosure of Markets

If you can offer only one company's quote to a prospective client, there is duty upon you to make this limitation known before accepting and before placing any business on the clients behalf.

Product Disclosure

You have an obligation to inform your clients at all times about all aspects of the insurance products they have purchased including any changes affecting a policy which occur during the policy term. In addition, you must observe all relevant laws relating to public protection and disclosure of information to clients. Anyone dealing with unlicensed insurers must hold a "Special Brokers License" to deal with unlicensed insurer pursuant to the Insurance Act.

Conflict of Interest

In addition, you must not place yourself in a conflict of interest with your client unless your client approves of your intended conduct after you have openly, honestly and fully disclosed the existence of a conflict of interest. Where you receive any form of incentive or bonus for placing business with an insurer, this must be disclosed to your client if it is a factor in recommending that insurer over another at the client's expense or detriment.

Tied Selling

Under the Federal Competition Act, it is an unfair or deceptive act or practice for an agent or broker to assist in or engage in the practice of "tied selling".

Note: The above section on Conflict of Interest is of particular note since the broker must disclose any incentive or bonus "if it is a factor in recommending that insurer over another at the client's expense of detriment."

SECTION 7 – MANNER OF SERVICE

AGENTS OR BROKERS SHALL MAKE SERVICES AVAILABLE TO THE PUBLIC IN AN EFFICIENT AND CONVENIENT MANNER WHICH WILL COMMAND RESPECT AND CONFIDENCE AND BY MEANS OF WHICH IS COMPATIBLE WITH INTERGRITY AND EFFECTIVENESS.

COMMENTARY:

Basic Principles

The means by which insurance is made available to the public must not detract from the integrity or effectiveness of the insurance agents or brokers. This obligation must be kept in mind when the broker is determining particular methods of operation, marketing or advertising.

SECTION 8 – MAINTAIN INTEGRITY OF THE PROFESSION

AGENTS OR BROKERS SHALL ASSIST IN MAINTAINING THE INTERGRITY OF THE PROFESSION AND SHOULD PARTICIPATE IN ITS ACTIVITIES.

COMMENTARY:

Duty to Report Misconduct and Incompetence

Where an agent or broker who tends toward professional misconduct is not checked at an early stage, loss or damage to clients or others may ensue. Evidence of minor breaches may, upon investigation, disclose a more serious situation or may indicate the beginning of a course of conduct which could lead to serious breaches in the future. It is therefore proper for you to report to the Insurance Council of Manitoba (the "Council") any instance involving a breach of the Insurance Act, its regulations, this Code of Conduct or the General Insurance Agents Licensing Rules by any agent or broker. Where, however, there is a reasonable likelihood that someone will suffer serious damage as a result of an apparent breach of the Insurance Act, its regulations, this Code of Conduct or the General Insurance Agents Licensing Rules, you have an obligation to report the matter to Council.

In all cases, such a report must be made in good faith, without malice or ulterior motive.

You shall attempt to persuade and assist any member of the public to report any facts to the Council which may constitute an act of misconduct.

You have a duty to reply promptly to any communication from the Council.

Brokers understand the need to place the interests of the consumer over their own. Not only does this apply under the law of agency where the agent's fiduciary duty to the client is clearly noted but also in the materials approved by the Superintendent of Insurance as a prerequisite for licensing.

In addition the Insurance Brokers Association of Manitoba's Code of Ethics reinforces the requirements for its members and its actions:

To the Public

- To remember that my first obligation is to my clients and to the insuring public.
- To provide my clients with the highest standard of professional service.
- To ensure that my advice to them is based on the highest level of professional integrity and performance.

Rules of Professional Conduct

- To show faith in the worthiness of my vocation by industrious application so that I may merit a reputation for quality service.
- My advertising will be moderate and when publicizing or offering my service, I will have due regard for the dignity of my profession.
- I will always put the legitimate interest of my clients and my loyalty to them before my own profit.
- I will always give constant attention to my professional training and update my knowledge of Insurance so that I will not be a mere Insurance distributor, but rather bring an original contribution to the provision of coverage; one that is tailored to the client's needs.

BROKER COMPENSATION

The schedule of Manitoba Public Insurance fees and commissions is presently available to the consumer as a public document. Brokers fees and commissions are established following the annual review of the rate application. We have attached a copy of the present Agents' Commission and Flat Fee Schedule.

Property and casualty commissions fall between 10 and 20% of the premium. Manitoba is the only province in Canada that does not permit the broker to charge both a fee and a commission. In recent discussions with respect to the re-write of the Insurance Act, government and brokers have agreed to incorporate a change requiring brokers to disclose any fee in writing in advance of delivering the services. This is true transparency.

Many of the services provided by brokers are carried out without an additional fee, such as the addition of a mortgage. Others result in the reduction of commissions, such as deletion of a property.

All sales and service industries have systems in place for motivating sales staff. In the insurance industry, these create a reason, not only to make the initial placement, but more importantly, they act to create incentives for post sales service including risk management and claims service. Brokers who sell new accounts, only to have existing

clients leave the brokerage because they have received poor service or because other brokers entice them with a promise of better service, will not receive contingency bonuses.

Contingent profits are calculated at the end of the insurer's accounting year. It would be impossible for a broker to disclose its profit on the entire portfolio of the insurer's business until the calculations have been completed and disclosed to the broker several months later. It is also unlikely that the broker could ever determine how much that particular client's account contributed to the contingent cheque.

The analysis of Rothschild and Stiglitz (1976) also shows that profit based contingent commissions align the interests of the broker and the insurer in creating the correct pricing of policies and in preventing adverse selection. When insurers have the benefit of more risk information from its front-line underwriters, the brokers, it brings stability to the market by charging the correct price for the product based on the potential losses. Brokers help identify physical and moral hazards. Conscientious insureds will improve their chances of avoiding an insurance claim by taking the loss prevention or loss reduction advice provided by the broker or insurer. Future insurance premiums will be reduced when the past claims experience and future expectation of claims payments are lower due to better loss control by the insureds. Where the risks have been improved, this results in savings for insureds, insurance industry and the general public as a whole. Contingency profit payments and the services provided by brokers to earn these payments benefit society.

Insurer profitability is of paramount concern for Manitoba brokers. With government automobile insurance, only a small volume of business is available for private insurers. If compounded with bad claims experience, this low underwriting cash flow would cause more insurers to pull their business out of the province. The result would be little competition and higher prices, or individuals and businesses without insurance coverage. Both would adversely affect the economy of Manitoba. Reducing losses and writing profitable business becomes more important to the insurance industry than contingency commissions.

The issue that created the need for this discussion resulted from and is limited to the Marsh & McLennan case in the United States. This brokerage was clearly involved in the illegal activities of price-fixing, bid-rigging and fraud. It was the illegal practices of obtaining fictitious high quotes from insurance companies in order to deceive its clients into believing that true competition had taken place that should remain the focus of concern for consumers and the insurance industry. The State of New York had regulations and sanction in place to deal with this brokerage and other intermediaries who violate its laws.

In a statement from the Attorney General Eliot Spitzer of New York, "We are persuaded that the goals that would have been advanced by a criminal prosecution of the corporation – punishment, restitution, general deterrence, and industry reform – will be better accomplished by criminal prosecution of individuals, adoption by the company of dramatically new business procedures, installation of new leadership, a full examination of prior wrongdoing and a pledge of restitution to those harmed." This statement shows the depth of present actions that would also be available in every province in Canada under its present laws.

TRANSPARENCY OF OWNERSHIP

In the small communities of Manitoba, the perpetuation of the brokerage force is important to the members of that community. In recent years, many have suffered the closing of a bank branch. Loss of the insurance brokerage would further affect the economic life of the community with the loss of jobs and access to financial services.

The shareholder value that exists in provinces with private automobile insurance does not exist in Manitoba. In those private automobile provinces, this value may represent 60% of the total volume and is included in determining the sale price of the brokerage. The Autopac volume does not have the same value and is non-transferable. In addition, Manitoba Public Insurance is making no new appointments. The only way to obtain this market is to buy a brokerage with an existing MPI agreement and to meet the location requirements. This restricts entry into the industry and the opening of new brokerages.

Small to medium business, such as insurance brokers, often have difficulty obtaining bank loans to purchase additional businesses or for new owners to secure money to buy out existing brokerage owners. This is compounded by the fact that the greatest value in brokerages is goodwill and not the usual physical assets found in other businesses. Banks have difficulty lending money to owners or perspective owners based on this intangible security. The Banker's Association also continues to lobby the federal government for entry into the distribution of property and casualty insurance at the branch level. This causes concern to a broker who may be obtaining a loan from a future competitor.

Because of these issues, brokers and insurers have entered into ownership arrangements. Insurance companies recognize the intrinsic value of brokerages in small communities and the goodwill component of valuation. Brokers have a source of funding to perpetuate their business and insurers have a secure market for their products. In addition brokers are able to develop enhanced products and policy coverages to meet the specific needs of their customers. These are always to the advantage of the consumer.

As a broker, however, this does not mean that business is directed only to the financing insurer. One insurer alone cannot meet the needs of all clients. In keeping with the principle of spreading the insurance risk in general, brokers also understand the value of spreading the risk among insurers. In fact that is the fundamental principle upon which a broker is based and separates them from an insurance agent.

Therefore, due to the economics of the industry in Manitoba, the position of insurer as lender to brokerages provides stability and perpetuation to the industry and continues to provide consumers with access to professionals in the communities in which they live.

CONCLUSION

The present system of consumer protection provided at all levels of government and reinforced by the industry itself is working well. Consumer satisfaction levels are high based the established standards of professionalism provided by their brokers and the healthy, competitive industry that presently exists in Manitoba. Additional compliance requirements or laws restricting broker compensation would cause increased price and restricted access to products required for the economic welfare of the province.

INSURANCE BROKERS ASSOCIATION OF MANITOBA

The Insurance Brokers Association of Manitoba (IBAM) is the non-profit, trade organization with voluntary membership representing 89% of eligible members. Its mission is to ensure that insurance brokers are the primary provider of insurance products and services in Manitoba. IBAM is the major supplier of licensing and continuing education for general insurance brokers in Manitoba, and represents the interests of its member brokers to government, industry stakeholders and members of the public.

IBAM represents over 1500 property and casualty insurance brokers in 296 offices. These offices are in 114 rural towns and communities, as well as, in Winnipeg. Member offices are the consumer's choice for the vast majority of all property and casualty insurance policies and premiums written in the province. The majority of brokerages are small to medium sized offices (SME) as only ten brokerages have more than twelve licensed brokers.

REFERENCES

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General Insurance Council of Manitoba, "General Insurance Agent Code of Conduct"

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Rothschild, Michael, and Joseph Stiglitz, 1976, "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information," Quarterly Journal of Economics 90:629-649

Spitzer, Eliot, 2004 "Statement by Attorney General Eliot Spitzer Regarding the Marsh & McLennan Companies," Office of the Attorney General of the State of New York, New York

AGENTS' COMMISSION AND FLAT FEE SCHEDULE

		OLD		TRANSACTION	COMMISSION %	CLASS
TYPE	TX CODE					
BASIC AUTOPAC	NEW	300	1. REGULAR, COMMERCIAL & ORV TRANS. New Registration Renewal Late Renewal		5	A1 (Excluding Insurance Use -- Transit) A2, A4, A5, A6, A7, A8 (Excluding Semi-Trailers) B1 C1 & C2
	REN/RE	360, 364, 365			5	
	REA	362				
AUTOPAC OPTIONAL COVERAGE	NEW	300	2. DECLARED EXCESS VALUE (MIV) New Registration Renewal Late Renewal		12 1/2	A1 (Only Insurance Uses -- Pleasure (Pass Veh, Mhome), School (Pass Veh, Bus), All Purp (Pass Veh, Mhome), Farm (Pass Veh), Farm All Purp (Pass Veh), Recreation (Mhome)) A2, A5 (Only Insurance Uses -- All Purp (Truck), Pleasure (Truck)) A5, A6 -- Farming/Fishing All Purp (Truck), A7, A8 (Excluding Semi-Trailers)
	REN/RE	360, 364, 365			12 1/2	
	REA	362				
	NEW	300	3. OPTIONAL EXTENSION New Registration Renewal Late Renewal		12 1/2	A1, A2, A5, A6 (Only Insurance Uses -- Pleasure (Pass Veh, Mhome), School (Pass Veh, Bus), All Purp (Pass Veh, Mhome), Farm (Pass Veh), Farm All Purp (Pass Veh), Recreation (Mhome), Farming/Fishing All Purp (Truck) All Purp (Truck), Pleasure (Truck))
	REN/RE	360, 364, 365			12 1/2	
	REA	362				
FLAT FEE TRANSACTIONS	TYPE	OLD TX CODE	FLAT FEE TRANSACTION		FEE \$	CLASS
	1. REGULAR TRANSACTIONS					
	CIF	170	Change of Name and/or Address		2.00	A1 (Excluding Insurance Use -- Transit) A2, A4, A5, A6, A7, A8 (Excluding Semi-Trailers), C1, C2 (Federal Govt. insurance exempt vehicles excluded for all of the above classes).
	CHG	220, 340	Insurance/Load Change/Coverage Reduction		5.00	
	TSF	320	Vehicle Transfer		5.00	
	EST	321	Estate-To-Spouse Transfer		5.00	
	DCC	380, 381	Document Replacement (Plates and Stickers only)		2.00	
	CAN	400	Cancellation of Policy		2.00	
	OTH	005	Single Trip Weight Increase Permit		2.00	B3
	OTH	005	Transit Permit		2.00	B7
	2. OFF-ROAD VEHICLES ACT					
	CIF	170	Change Customer Information		2.00	B1 Only - This section includes Federal Govt., Federal Crown Corporations, other State/Province and Consular vehicles which are insured under Basic Autopac.
	CHG	220, 340	Change Vehicle Class/Change Policy Details		5.00	
	TSF	320	Vehicle Transfer		5.00	
	EST	321	Estate-To-Spouse Transfer		5.00	
	DOC	380, 381	Document Replacement (Plates and Stickers only)		2.00	
	CAN	400	Cancellation of Policy		2.00	
	NEW	300	New and Renewal (Flat fees for these transactions do not apply if vehicles are insured under Basic Autopac).		2.00	B1 (Insurance exempt vehicles only) (NOTE: not applicable to agents for Consular vehicles)
	REN/RE	360, 364, 365				
	REA	362				
	3. SEMI-TRAILER (REGISTRATION ONLY)					
	NEW	300	New Registration		2.00	A8 Only (Excluding Federal Govt. vehicles)
	REN/RE	360, 364, 365	Renew		2.00	
	REA	362				
	TSF	320	Vehicle Transfer		2.00	
	DOC	380, 381	Document Replacement (Plates and Stickers only)		2.00	
	4. FARM TRUCKS					
	NEW	300	Additional Commission for Agents on Applicants in Terr. 2 (Incl. Terr. 5)		3.00	A6
REN/RE	360, 364, 365			3.00		
REA	362					
5. VEHICLES						
NEW	300	Additional Commission for Agents on Applicants in Terr. 2 (Incl. Terr. 5)		2.00	A1 (Excluding Insurance Use -- Transit) A2, A5	
REN/RE	360, 364, 365			2.00		
REA	362					
6. FEDERAL GOV'T. AND OTHER STATE/PROVINCE VEHICLES						
CIF	170	Change Customer Information		2.00	Federal Govt. -- Owned Vehicles only	
CHG	220, 340	Change Vehicle Class/Change Policy Details		2.00		
NEW	300	New and Renewal (Flat fees for these transactions do not apply if vehicles are insured under Basic Autopac).		2.00	Federal Crown Corps. and other State/Province - Owned vehicles only	
REN/RE	360, 364, 365					
REA	362				A1, A2, A4, A5, A7, A8, A9, B1 Federal Govt. -- Owned Vehicles only, Remote Area A1, A2, A4, A5, A7, A8	
TSF	320	Vehicle Transfer		2.00		
DOC	380, 381	Document Replacement (Plates and Stickers only)		2.00		
CAN	400	Cancellation of Policy		2.00		