

Relationships between Insurers and Sales Intermediaries – Consultation Paper (June 3, 2005)

Submission by the Public Interest Advocacy Centre (10 August 2005)

This consultation focuses on possible policy options that should be applied to Property and Casualty (P&C) insurers and Life and Health (L&H) insurers to govern the relationship between insurance companies and their sales intermediaries. The purpose is to reduce the opportunity for actual and potential conflicts of interest that may arise under existing financial relationships between these parties, such as contingent commissions, ownership links and sales incentives.

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to provide input on this important consumer issue. Our organization undertakes legal and research services on issues of major public concern. We focus on those issues that involve the delivery of important public and utility services such as telecommunications, energy, privacy, electronic commerce, financial services, broadcasting, intellectual property and competition law.

Our comments will follow generally the headings and the questions included in the consultation paper.

Policy Options

The policy options suggested by the 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. PIAC is in favour of the implementation of all three policy options.

We believe that legislation or regulation in all of these areas is needed to ensure that the parties involved in an insurance contract understand that the client's interest must be placed above that of an intermediary or any third party. It is only through the application of all three policy approaches, which tackle the issue from the consumer, the intermediary and the industry plane, that potential conflicts of interest can be effectively addressed

The findings of the market conduct questionnaire reveal current business practices that clearly create the appearance that the client's interest may be in jeopardy in undertaking insurance contracts in the personal and property insurance sectors. These are the findings we are specifically concerned about:

- More than 2/3 of P&C insurers offer contingent commissions to their agents or brokers.
- More than ½ of P&C insurers report having loans, ownerships and other kinds of financial relationships with sales intermediaries.
- The use of sales incentives, including non-monetary sales incentives “appears to be universal” among L&H insurers.
- Companies representing more than half of the market share among L&H insurers report having loans, ownerships and other similar financial relationships with sales intermediaries.

PIAC has extensive experience with various regulatory approaches to industry. We have participated in the formation of and administration of voluntary codes as well as the establishment of legislative regulatory frameworks for various industries. In a market-driven industry such as insurance, where there is such a close relationship between intermediaries and insurance companies, the potential for the appearance of and the fact of conflict of interest is high. It is for that reason we believe consumers can best be protected by comprehensive legislation that addresses potential conflicts from a number of fronts aimed at the consumer, the intermediary and the industry, not by industry-controlled self-regulation.

One of the questions posed asks, as a consumer/client, which of the policy options would offer the most value in making insurance purchasing decisions. All of the options, alone, are insufficient. We believe that all three policy approaches are needed to fully protect consumers and retain public confidence in the insurance industry.

Scope and Applicability of Policy Options

It is important that legislation and/or regulation have a broad application and scope and therefore apply to all intermediaries. The relationship that most consumers have to insurers demands this and the current structure of regulation of insurance necessitates this.

Most consumers don't have and shouldn't be expected to have a nuanced understanding of the insurance industry to know when and where they are protected as consumers. Most consumers do not distinguish between intermediary functions such as brokers and agents (career versus independent) or know of the different classes of licences depending upon the type of insurance or the geographical jurisdiction. The administrative structure of insurance is complex and not consumer friendly. The insurance industry also employs a standard form contract, which is effectively impenetrable to the average person.

Intermediaries are regulated at the provincial/territorial level by legislation and also by common law. The variety of legislative requirements by jurisdiction

together with general common law obligations is already complex; to place on top of that a regulatory framework, which would apply by type of intermediary would create a maze of complexity of consumer protection that most consumers would not be able to begin to fathom.

Performance-Linked Benefits Provided by Insurers to Intermediaries

The awarding of monetary and non-monetary benefits by insurers to intermediaries beyond regular commissions is the most questionable and problematic aspect of the insurer-intermediary relationship. The awarding of a benefit linked to performance creates an overwhelming perception, despite any reality, that acting in the best interest of the consumer to find the most appropriate and/or cost-effective insurance product will be supplanted by other considerations.

The policy option we would favour for dealing with performance-linked benefits would be an absolute restriction. To determine what constitutes a performance-linked benefit, the relevant rules should be principle-based. Although it would appear to be relatively straightforward to determine practices and benefits that should be restricted, there is always the potential to look for and find loopholes when there is a list of specific prohibitions. A principle-based approach would allow for more comprehensive regulation of this aspect of the relationship between insurers and intermediaries.

Disclosure

Adequate disclosure is critical for helping consumers make informed choices in the market and retain confidence in the insurance industry. Information about how an intermediary is paid for services and how much the intermediary earns from the sale of a policy to a consumer would create a welcome and novel transparency in an industry that has to date been effectively veiled in terms of its relationships and practices.

We prefer that legislated disclosure requirements be put in place as outlined in Appendix 1 to the consultation paper. For the reasons we have argued above, the close nature of the relationship necessitates a legislative framework that arises external to the industry.

L&H Insurance

We believe that all L&H products should be subject to the same requirements.

Regulatory Compliance

The cost-effectiveness of the policy options is neither the appropriate question nor the appropriate standard of evaluation of the proposed intervention into the insurance industry. One could also ask what the cost-effectiveness for the consumer is in an industry where additional monetary and other benefits are allowed to prevail over and above the normal 'price' set by the market? What is the implication for consumers and the economy overall in terms of inadequate or inappropriate insurance products choices that might result where the best interests of the client may not prevail? What is the implication for the consumer in terms of the overall cost of the insurance product?

The imposition of regulation should also not be premised solely upon whether it is cost-effective or not. Governments and businesses may regulate for a number of important public policy reasons, beyond cost considerations. In this case, the social and economic public policy goal as indicated in the consultation paper itself is to "enhance public confidence in the Canadian insurance marketplace." This is a non-monetary consideration that directly impacts both the industry and consumers.