NEWS RELEASE

For Immediate Release

Canadian Council of Insurance Regulators
Canadian Insurance Services Regulatory Organizations

CCIR-CISRO Position on the Discussion Paper on Upfront Compensation in Segregated Funds

May 15, 2023

TORONTO – The Canadian Council of Insurance Regulators ("CCIR") and the Canadian Insurance Services Regulatory Organizations ("CISRO") are announcing actions they intend to pursue following the public consultation held in the Fall 2022 in the CCIR/CISRO Discussion Paper on Upfront Compensation in Segregated Funds ("Discussion Paper").

Based on the results of the consultation and on the information currently available, CCIR and CISRO have concluded that:

- Without appropriate control measures, there is a risk of customer harm if insurers pay intermediaries for selling individual variable insurance contracts ("IVICs" also known as individual segregated fund contracts) and require the intermediaries to repay some or all of the commission if the customers withdraw money within a specified time (the "Advisor Chargeback" sales charge option),[1]
- For example, upfront commission may motivate advisors (particularly less experienced advisors who have lower incomes) to sell this product to customers for whom the product is not suitable,
- The insurance industry believes Advisor Chargeback gives some customers a way to access advice, and that there may be unintended negative consequences if this option is banned, and
- The risks of Advisor Chargeback call for, at a minimum, robust control measures to ensure customers are treated fairly when this option is used.

CCIR and CISRO will therefore:

- Develop regulators' expectations with regards to appropriate controls to be put in place for Advisor Chargeback and incorporate them into guidance they are creating with respect to the design, sale and servicing of IVICs more generally,
- Publish the combined draft guidance for public comment,
- Share information about their findings with the Canadian Securities Administrators ("CSA"),
- Monitor any work the CSA undertakes with respect to similar compensation models on the sale of mutual funds,
- Publish final consolidated guidance on segregated funds, and
- Monitor the customer outcomes related to upfront compensation on IVICs.

Should CCIR and CISRO, or any of their individual members, become aware of unfair outcomes in the future, we will consider taking further action.

---

[1] One of the key differences between the DSC and Advisor Chargeback sales charge options relates to who reimburses the insurer for the cost of intermediary compensation when the customer redeems segregated fund units before the end of a fixed schedule. Under the DSC option, the customer pays the insurer a redemption fee based on how long the customer has held the segregated fund units according to a pre-determined schedule. Under the Advisor Chargeback option, the intermediary returns all or a portion of the commission it received from the sale of segregated funds back to the insurer, again based on how long the customer has held the segregated fund units according to a pre-determined schedule.

Policy Position and Initiatives on Upfront Commissions in Segregated Funds

CCIR and CISRO believe that the risks of negative outcomes of upfront commissions, such as Advisor Chargeback in segregated fund sales, call for, at a minimum, robust risk control measures and regular reviews of the effectiveness of these controls. Based on the Discussion Paper responses and follow-up with stakeholders, CCIR and CISRO believe insurers that offer the Advisor Chargeback sales charge option to customers should put in place at a minimum, the following robust risk control measures:

- Manage the conflict of interest between a customer and an intermediary, by
  - Using a short duration for chargeback schedules;
  - Not inappropriately increasing the segregated fund management expense ratios as a result of paying upfront commission;
  - Permitting a portion of an investment to be redeemed each year without incurring a chargeback;
  - Avoiding time-limited increases to commission payments for promotional purposes;
  - Offering various sales charge and fee options to customers at the point of sale;

- Educate customers, at the point of sale and for the duration of the chargeback schedule, about their sales charge options, and raise the customers' awareness and control over the conflict of interest that Advisor Chargeback represents; and

- Monitor for unfair treatment of customers (including by collecting appropriate data to measure the effectiveness of their control measures):
  - During and shortly after a chargeback schedule;
  - In sales by intermediaries with chargeback debt or a history of inappropriate deferred sales charge ("DSC") sales; and
  - To determine whether customers are being informed about their sales charge options.

In addition to the control measures specific to Advisor Chargeback set out above, CCIR and CISRO are also working on expectations on standards of care for the sale and servicing of segregated funds. These expectations are applicable for all sales charge options, including Advisor Chargeback, and will require insurers to put in place control measures reasonably designed to:

- Ensure customers receive suitable advice with respect to purchasing a new IVIC or a transaction for existing IVICs;
- Manage risks associated with a leveraging or replacement strategy involving an IVIC, including risks associated with upfront commission; and
- Provide appropriate product training to their salesforce in order to ensure that they target customer groups to whom the product is suitable, explain IVICs correctly when dealing with customers and understand what information they need to gather from the customers to determine if the product is suitable for the customer's particular circumstances.

CCIR and CISRO believe the above measures can help achieve the Target Customer Outcomes set out in the Discussion Paper. Some insurers may have the above controls in place already.

In addition, any intermediary who pays another intermediary or agent upfront compensation for selling IVICs under the agreement that the selling intermediary or agent will repay some or all the compensation if the customer withdraws money within a specified time will be expected to implement similar risk control measures. Intermediaries may also be expected to implement some of the risk control measures with respect to payments insurers make to the intermediaries who sell these products pursuant to local requirements in some jurisdictions.

Next Steps

In line with the policy position and initiatives, CCIR and CISRO announced in February 2022 that regulators are working on their respective approaches to DSC bans in their jurisdictions. Next, we intend to focus our efforts on drafting guidance on segregated fund market conduct expectations for public consultation. The market conduct guidance will incorporate upfront commission expectations, drawing from (but not limited to) the list above.

CCIR and CISRO remain concerned that advisors (in particular, inexperienced advisors) may sell products such as IVICs to customers for whom the product is not suitable. In the *Conduct of Insurance Business and Fair Treatment of Customers* Guidance, CCIR and CISRO expect insurers to, among other things, "target the Consumers for whom the product is likely to be appropriate, while preventing or limiting inappropriate sales." CCIR and CISRO also expect insurers to take into account the interests of the targeted consumer groups when developing and distributing insurance products. We recognize that there are many connections between product suitability and conflicts of interest involved with compensation, and believe it is important to release guidance that deals with both aspects, to provide comprehensive conduct expectations to insurers and intermediaries. Stakeholders will have an opportunity to comment on both sets of measures during the consultation period for the market conduct guidance.

While the segregated funds market conduct guidance continues to be drafted, CCIR and CISRO note that the CSA intends to "[r]eview and modernize NI 81-105 *Mutual Fund Sales Practices* and contemplate whether amendments are necessary in light of the Client Focused Reforms"[2] and that this work may include examining the "use of the Principal Distributor Model and/or the use of dealer chargebacks that raise conflict of interest concerns."[3] CCIR and CISRO will monitor developments in this CSA project and will share information from our work on segregated fund upfront compensation with the CSA.

CCIR and CISRO will continue to monitor the customer outcomes relating to upfront compensation in segregated funds. Once the guidance is implemented, CCIR members intend to work cooperatively to assess the effectiveness of the risk control measures. This may include data collections or other supervision activities as appropriate. Should CCIR and CISRO become aware of unfair outcomes in the future, we will consider taking further action.

Background

Selling and Servicing IVICs

Since the release of the CCIR Segregated Funds Working Group Position Paper in 2017, CCIR and CISRO have been working together on regulators' expectations for segregated funds, including conduct guidance to explain how insurers and intermediaries should sell and service IVICs. The guidance will help ensure IVICs, IVIC investments and other IVIC-related transactions will be suitable for customers. Regardless of the sales charge option the customer chooses, the guidance will set expectations for intermediaries about:

- the information they should gather about their customers before giving them advice ("Know Your Client")
- knowledge of the products they sell ("Know Your Product")
- how and when to assess what their clients need
- how to give suitable advice
- what information to give customers before they buy IVICs or make other transactions.

---

[2] 2022-2025 CSA Business Plan at Strategic Goal 3.6 Continue the modernization of mutual fund sales practices.
[3] OSC Notice 11-797 – Statement of Priorities - Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2024 at 2.3 Monitor and Respond to the Impacts of the Deferred Sales Charges Ban (DSC ban) and Order-Execution-Only Ban (OEO ban).

In addition, it will set special expectations where a customer borrows money to invest or replaces an IVIC investment and will set expectations for insurers to ensure intermediaries are properly trained and supervised.

From May to December 2022, CCIR and CISRO conducted pre-consultation meetings with industry. The verbal and written feedback provided will be considered as the guidance development continues.

Upfront Compensation in IVICs

There are currently two main situations in which insurers pay intermediaries upfront commissions when they sell IVICs: the DSC model and the Advisor Chargeback model. In February 2022, CCIR and CISRO announced their position on the use of DSCs in segregated fund contract sales, and their intention to consult on other upfront commissions in segregated funds and IVICs.

In September 2022, CCIR and CISRO released the Discussion Paper for a 60-day consultation period to fully understand:

- Compensation arrangements in segregated funds and IVICs, and what other changes to upfront compensation may be needed, including understanding the impacts of a complete ban of upfront commissions or other measures that could be taken to improve Customer outcomes;
- Potential impacts for Customers, Intermediaries, and Insurers; and
- What would be a reasonable period of time for the industry to adapt to any changes.

Incentives for Selling Insurance

During the same timeframe and in the same spirit, after a thorough consultation process, CCIR and CISRO issued the Incentives Management Guidance ("IMG") on November 30, 2022. The IMG speaks to principles in the areas of i) governance, ii) design and management of incentive arrangements, iii) risks of negative outcomes to customers, and iv) controls, and also provides current in-market examples where risks of negative customer outcomes can occur if not properly managed. Some of the examples provided could be relevant to segregated funds, including:

- Incentive arrangements which can result in fees or penalties, (e.g., exit fees) for the customer, including DSCs;
- Chargeback mechanism influencing the intermediary to recommend the customer to maintain a product that is inappropriate or unsuitable, so that the intermediary is not required to repay compensation;
- Commissions linked mainly to the premium level or the investment amount;
- Unjustified discrepancies between commissions for initial sale and ongoing services, which can cause intermediaries to propose a replacement transaction with no clear benefit for the customer in order to receive greater compensation.

About CCIR

The Canadian Council of Insurance Regulators is an inter-jurisdictional association of insurance regulators. The mandate of the CCIR is to facilitate and promote an efficient and effective insurance regulatory system in Canada to serve the public interest. CCIR members work together to develop solutions to common regulatory issues.

About CISRO

The Canadian Insurance Services Regulatory Organizations is a forum of Canadian regulatory authorities who are dedicated to consistent qualifications and conduct of business standards for insurance intermediaries. CISRO members collaborate on initiatives that support a consistent approach to consumer protection through the regulation of insurance intermediaries.

Media Contacts

Russ Courtney
(For English media - Toronto)
437-225-8551

Sylvain Théberge
(For Francophone media - Montréal)
514-940-2176