

**INDUSTRY PRACTICES REVIEW COMMITTEE
CANADIAN COUNCIL OF INSURANCE REGULATORS
and
CANADIAN INSURANCE SERVICES REGULATORY ORGANIZATIONS**

**Managing Conflicts of Interest:
A Consultation Paper on Enhancing and Harmonizing
Best Practices**

February 2006

Ce document est également disponible en français.

How to give us your comments

The Industry Practices Review Committee (IPRC) welcomes your comments on the recommendations presented in this consultation paper. These recommendations are intended to enhance and harmonize best practices in the management of actual or potential conflicts of interest in the insurance industry.

This paper and all prior IPRC publications are available on the CCIR's website, www.ccir-ccra.org.

Please send your comments by March 24, 2006 to:

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We intend to make the submissions received publicly available. Please indicate if you do not want your submission or specific parts of your submission to be made public. We will treat the submission or the designated parts as confidential to the limited extent permitted by law. We prefer to receive electronic submissions.

Please note that the recommendations contained in this consultation paper should not be construed as the official position of any provincial, territorial or federal government or agency.

Who we are

In October 2004, the Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO) established the Industry Practices Review Committee (IPRC) to ensure a coordinated national approach to regulators' review of the relationship between insurers, agents and brokers.

What this paper is about

This consultation paper is the third paper released by the IPRC on the subject of managing actual or potential conflicts of interest in the insurance industry. In June 2005, the IPRC released a consultation paper entitled *Relationships between Insurers and Sales Intermediaries* to outline the findings of two market conduct questionnaires and to ask stakeholders for comments on possible policy options. In November 2005, the IPRC released a second paper entitled the *Summary of Responses: Achieving Best Practices* to summarize the responses to the June 2005 paper. The recommendations described in the current paper have been developed from these earlier papers and should be read in conjunction with them.

These recommendations are intended to enhance and harmonize best practices in the management of actual or potential conflicts of interest in the insurance industry. The IPRC now seeks your comments on these recommendations and on the best means to implement them. For example, can the recommendations be achieved through industry initiatives, are regulations required, or a combination of both approaches?

General approach

The IPRC's broad-based review of the relationships between brokers, agents and insurers focused on best practices in managing conflicts of interest. This fact-gathering review did not uncover evidence of illegal insurance related activities. The CCIR and CISRO are also pleased to note the voluntary initiatives of both the life and health and property and casualty industries to promote best practices in managing conflicts of interest.

The results of the fact-gathering review, as well as existing initiatives, form the basis of the recommendations found in this consultation paper.

IPRC Recommendations

The IPRC has conducted a comprehensive review of a wide range of best practices. The IPRC is making three principle-based recommendations that focus on market place outcomes. These principles strengthen and harmonize requirements that are, to a large extent, already in place across Canada. If regulators' monitoring of the marketplace identify problems in the future that require additional action, further steps can be taken, including the development of more prescriptive rules. This can be described as a progressive approach to market conduct.

Subject to this consultation, the IPRC intends to recommend to CCIR and CISRO the following principles for regulators to consider and industry associations to support as appropriate means to manage actual or potential conflicts of interest associated with insurance advice or transactions.

1. Priority of the client's interest: An intermediary must place the interests of policyholders and prospective purchasers of insurance ahead of his or her own interests.
2. Disclosure of conflict or potential conflict of interest: Consumers must receive disclosure of any actual or potential conflict of interest that is associated with a transaction or recommendation.
3. Product suitability: The recommended product must be suitable for the needs of the consumer.

Recommendation 1: Priority of the client's interest

Principle: An intermediary must place the interests of policyholders and prospective purchasers of insurance ahead of his or her own interests.

Commentary:

Currently, many codes of conduct, insurance council by-laws, and industry association codes contain provisions that are consistent with the principle of the priority of the client's interest. However, the wording of these provisions differs from jurisdiction to jurisdiction. The objective of this recommendation is to promote harmonization between jurisdictions to avoid situations where agents and brokers may be subject to differing requirements in industry codes, by-laws or regulations. Wherever possible, harmonized language should be used to describe the priority of the client's interest in regulation, council by-laws and industry codes.

Priority of the client's interest is the paramount principle. Examples of expected conduct or practices are:

- A broker or agent must not knowingly prejudice the interests of a client or consumer for personal gain.
- A broker or agent must not take advantage of a client's or an insured's inexperience, ill health or lack of sophistication.
- A broker or agent must be both candid and honest when advising the client or consumer.
- A broker or agent must act with integrity, competence and the utmost good faith.

Recommendation 2: Disclosure of conflict or potential of conflict of interest

Principle: Consumers must receive disclosure of any actual or potential conflict of interest that is associated with a transaction or recommendation.

Commentary:

Many jurisdictions currently have requirements related to disclosure.¹ These disclosure requirements may be broader than actual or potential conflict of interest and include other information that is also important for making purchase decisions. The discussion here focuses on managing potential conflicts of interest.

¹ For further information about existing disclosure requirements for insurance brokers and agents, please see Appendix 1 of the *Summary of Responses: Achieving Best Practices* (November 2005).

In regard to potential conflicts of interest, disclosure should be brief and relevant to the purchase decision in order to be useful to the consumer. Disclosure formats should be flexible and tailored to different products and distribution channels.

The broker or agent has the responsibility to ensure that the consumer is informed of all relevant information before the consumer makes a decision regarding a purchase. Information that can assist in managing potential conflicts of interest and that should be disclosed includes:

- Insurers represented and the name of any insurer(s) with which a significant volume of business is placed;
- Extent of the search by the broker or agent for a competitive price and suitable product within the markets available to that agent or broker;
- Methods of compensation (salary, commission or other arrangements such as contingent profit commission or bonus); and
- Other relationships that may create actual or potential conflicts of interest, including ownership, loans and other financial links and non-monetary benefits. The IPRC recognizes the importance of access to capital by brokerages or agencies, which can support efficient and competitive distribution channels. Agents, brokers and insurers should ensure that any such arrangements are not detrimental to the interests of the consumer such as restricting choices of insurers.

All insurers should disclose on their websites or make publicly available clear and concise information about their relationships with intermediaries. Examples are:

- Ownership, financial links or arrangements with intermediaries, such as loans;
- Methods of compensation, including percentage range of compensation, for each major line of business or type of product; and
- Non-monetary benefits and contingent profit commission or bonus.

Providing brief and relevant disclosure empowers consumers to take a more active role in making decisions about their insurance purchase. If consumers understand the range of products and companies available to the broker or agent, they can decide if a further search (for example, for a more competitive price) is required. In addition, disclosure helps consumers understand factors that might influence a product recommendation and may encourage consumers to ask additional questions.

Recommendation 3: Product Suitability

Principle: The recommended product must be suitable for the needs of the consumer.

Commentary:

Many industry association codes, insurance council by-laws and codes of ethics require a broker or agent to obtain information about the client's needs and recommend appropriate insurance coverage. There is also case law on the standard expected in terms of assessing the client's needs and requirements.

Recommending a product is an integral part of the broker or agent's advice to their clients. The IPRC expects that brokers and agents will explain to their clients and document the reasons for recommending a particular product. In situations where the product is offered without advice, the broker or agent should inform the client that no advice is being offered.

Building on the first recommendation, the IPRC is recommending this principle because suitability of recommended products is a more direct measure of success in managing conflicts of interest. If a broker or agent can demonstrate that the recommended product is suitable and has made disclosure as described in the second recommendation, then any actual or potential conflict of interest from compensation, ownership or financial links is likely to have been adequately managed.

In order to understand the client's interests, the intermediary must obtain or confirm information about their needs and when making a recommendation, must reasonably ensure that any product or service offered is suitable to fulfill those needs.

Suitability depends on the needs, facts and expectations of the client. Examples of expected outcomes are:

- A broker or agent should conduct fact finding appropriate to the circumstances and assessment of the client's insurance needs.
- Needs assessment should be flexible — the assessment should reflect factors including the underlying risk, the client's objective and complexity of the product being sold.
- An agent or broker's product recommendation should meet the client's needs.

Other matters raised in the 2005 consultation

During the consultation, two additional matters were considered in the context of managing conflicts of interest:

- Should independence be defined?
- Should performance-linked benefits and other financial links be prohibited?

The IPRC believes that the three recommendations may effectively address these matters for the following reasons:

- Actual or potential conflicts of interest from using the term “independent” are more effectively managed by disclosing the names of insurers the broker or agent represents, any concentration of business with specific insurers, and any financial links with those insurers.
- Actual or potential conflicts of interest from performance-linked benefits and financial links are more effectively managed by product suitability requirements, disclosure of concentration of business with specific insurers, and disclosure of compensation information.

Consistent with a progressive regulatory approach, if regulators’ monitoring of the marketplace identify problems in the future that require additional action, further steps can be taken at that time.

Implementation of recommendations and outcomes

The IPRC is seeking views from stakeholders about these recommendations and the roles of insurance associations, agents, brokers and regulators in achieving the principles and outcomes outlined in this paper. In particular, the IPRC would like to receive proposals from industry associations about what role they could play in addressing these principles or outcomes.

The IPRC acknowledges that regional differences may exist. Individual jurisdictions may implement the recommendations in conjunction with other measures that reflect any local or regional issues.

Next steps

The following next steps are contemplated:

1. The IPRC will review the comments from stakeholders, and will finalize its recommendations.
2. The recommendations and a communication plan will be presented to CCIR and CISRO for their considerations in the Spring of 2006, together with any stakeholder proposals or suggestions on implementation.
3. Following the CCIR and CISRO meetings, each regulator will then evaluate the circumstances in its own jurisdiction to determine what, if any, changes are necessary to implement the recommendations.
4. If it is determined that implementation of the recommendations should be accomplished through legislation or regulation, then the recommendations would become a matter for consideration by governments.

Consultation Questions

Stakeholders are welcome to provide comments on any aspect of the recommendations in this paper. We are particularly looking for responses to the following questions.

1. Do you feel that the principles or outcomes outlined in this paper reflect appropriate best practices in managing potential conflicts of interest?
2. Are there practical problems associated with the implementation of the recommendations outlined in this consultation paper?
3. What role could industry associations play in supporting their members in implementing these principles?