Consultation on Distribution of Insurance Other than through a Representative

Generally speaking, insurance of persons or damage insurance products are offered by a representative certified by the *Autorité des marchés financiers* (the "AMF"). Representatives must fulfill legal and ethical obligations, in particular with respect to knowledge of their clients and suitability of the products they offer them.

However, Title VIII of *An Act respecting the distribution of financial products and services*, R.S.Q., c. D-9.2 (the "Act"), which was introduced in 1999, provides for an exception regime for the offer of certain insurance products: "distribution other than through a representative", also known as "distribution without a representative" ("DWR"). Under this regime, an insurer may offer an insurance product relating to goods or secure a client's adhesion in respect of such a product through a distributor, provided that the distributor does not operate in the field of insurance, and that the product offered is related to the good being sold.

To benefit from this exception regime, the insurer must first prepare a distribution guide (the "guide") that complies with the provisions of the Act and the *Regulation respecting distribution without a representative*. A copy of the guide must be filed with the AMF before the product is distributed. As well, the insurer must take all appropriate steps to ensure that its distributors are sufficiently familiar with the product covered by the guide.

In addition to describing the insurance product, the distributor must give the consumer a copy of the guide before selling said product. Other obligations are stipulated under the Act, such as the duty to disclose any remuneration received where such remuneration exceeds 30% of the sale price of the insurance product.

Although it is an exception regime, DWR is fairly comprehensive and, in theory, seems to fulfill its role. However, over the years, the AMF has noted a number of issues related to the enforcement of provisions under the DWR regime. Accordingly, the AMF initiated a reflection and is submitting a report outlining its findings and proposing directions to improve the regime's effectiveness.

The AMF is therefore publishing for comment its report entitled "Issues and Consultation Paper on Distribution of Insurance Other than through a Representative".

Please note that any comments received will be posted on the AMF website, unless otherwise indicated.

Comments

Comments should be made in writing and sent **before February 25, 2011** to:

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ISSUES AND CONSULTATION PAPER ON DISTRIBUTION OF INSURANCE OTHER THAN THROUGH A REPRESENTATIVE

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BACKGROUND

Generally speaking, insurance of persons or damage insurance products must be offered by a representative certified by the *Autorité des marchés financiers* ("the AMF"). The representatives must fulfill legal and ethical obligations, in particular with respect to the knowledge of their clients and the suitability of the products they offer them.

Introduced in 1999, Title VIII of *An Act respecting the distribution of financial products and services, R.S.Q., c. D-9.2* ("the Act") allows an exception regime for the distribution of insurance products: *Distribution other than through a representative* also known as *Distribution without a representative* ("DWR"). Under that regime, an insurer may offer insurance products pertaining to a good or secure a client's adhesion in respect of such insurance products through a distributor, provided that the distributor's business is not in the field of insurance, and that the product offered is related to the good that is being sold.

To take advantage of this exception regime, the insurer must have prepared, in advance, a distribution guide ("the guide") that complies with the provisions of the Act and of the *Regulation respecting distribution without a representative* ("the Regulation"). A copy of this guide must be filed with the AMF, before the product is distributed. In addition, the insurer must take all necessary steps to ensure that the distributors are sufficiently familiar with the product described in the guide.

The guide must contain, in particular:

- a description of the product being offered and details on the nature of the guarantee
- the exclusions associated with the product
- the claim process
- a mention that similar insurance products do exist on the market

Furthermore, the distributor required to describe the product must also give a guide to the consumer prior to selling the product through the DWR regime. The guide constitutes a disclosure tool, which enables the consumer to evaluate the product that is being offered. Besides the obligation to deliver a copy of the guide, the Act imposes other obligations on distributors, such as the duty to disclose their remuneration if it exceeds 30% of the cost of acquiring the insurance product.

Given that the distributor proposing an insurance product to the consumer has no training in insurance (except for the one provided by the insurer about the product, as the case may be), or any obligation to know the consumer's needs or to determine the suitability of the product he or she is offering, the DWR regime is intended to provide the consumer with all the relevant information needed to make an informed decision.

As we can see, the DWR regime, even though it is an exception regime, is fairly comprehensive and, in theory, seems to fulfill its role. However, it is important to verify whether, in practice, the regime meets expectations and whether it is properly applied. It is to that end that the AMF undertook some fact-finding research, and now submits this brief presenting some of its findings and suggesting directions that might be taken to improve the regime's effectiveness.

DESCRIPTION OF THE DWR MARKET IN QUÉBEC

It is important to point out that the data used throughout the report express averages that, as well as the comments that arise from them, might not fully apply to certain distribution networks or certain types of products.

Little information was available about the DWR market. Consequently, the AMF compiled some quantitative and qualitative data on the products offered and drew a picture of the DWR market in Québec. Accordingly, in 2008, 47 insurers licensed with the AMF were offering 278 insurance products through this exception regime. These insurers reported to the AMF that there were 8,628 distributors offering products through their employees. Here is a picture of the DWR sector in the year 2008:

Insurance products offered through DWR	2008
Debtor life, health and employment insurance[1]	73%
Travel insurance	19%
Others	8%

Distributors	2008
Financial institutions	49%
Automobile dealers	31%
Travel agencies	13%
Others	7%

Persons covered by insurance under the DWR regime	2008
Persons who bought insurance in 2008[2]	5,604,480
Persons covered by insurance as at 2008-12-31	12,104,104

Premiums paid	2008
Premiums paid for new policies in 2008	$458,109,892
Premiums paid for existing contracts as at 2008-12-31	$2,017,540,559

Rate of acceptance	2008
Automatic acceptance	93%
Acceptance after a selection process	3%
Rejection	0.6%
Others (e.g. clients did not pursue)	3.4%

Claims	2008
Number of claims ▪ Number of claims vs. persons covered as at 2008-12-31	88,990 < 1%
Claims accepted	82%
Amounts paid ▪ Claims paid vs. premiums paid for contracts in force as at 2008-12-31	$396,844,617 < 20%

[1] Life and disability insurance associated with mortgage loans, personal loans or car loans, lines of credit and credit card balance insurance, among others, are included in this category.
[2] Travel insurance associated specifically with credit cards represents $28 million in premiums for over 3.5 million cardholders.

The insurers' administration fees, including those of their third party administrators or "TPAs", are between 10% and 15%. For 40% of the products sold, the distributor's average remuneration is 49%, i.e. above the 30% threshold that requires disclosure to consumers.

In 47% of cases, insurers outsource their responsibilities, in particular the supervision of distributors, to TPAs. We note that the insurers have supervisory processes, and that an inspection process of these TPAs exists in 25% of cases. We further note that inspection procedures of the distributors, either by the insurer or by the TPA to whom the insurer has delegated its responsibilities, exist in only 15% of cases.

MAIN ISSUES ASSOCIATED WITH THE DWR REGIME

The experience of the past ten years combined with our research nationwide and internationally, point towards six main issues associated with the DWR regime:

- **I.** Disclosure of information to consumers
- **II.** Rescission of the contract
- **III.** Supervision of distributors
- **IV.** Disclosure of distributors' remuneration
- **V.** Financing of single premiums
- **VI.** Use of telemarketing

For each of these issues, we will report on the main problems found and will propose various avenues of solution.

I. Disclosure of information to consumers

FINDINGS

Generally, as part of the offering of insurance products, a representative certified with the AMF discloses, directly or indirectly, considerable information for the benefit of the consumer.

On the DWR market, information is provided to the consumer in the form of a distribution guide, among other things. The guide is intended to disclose important matters to help consumers, in the absence of a certified representative, properly evaluate the insurance product being offered to them and determine its suitability.

Considering how important the guide is, its bulk and its complexity can have the effect of preventing it from achieving the objective for which it was designed.

After analyzing a sample of guides currently in use in the DWR market, we have calculated averages with respect to the information shown in the table below:

	Number of pages per guide	**Number of products offered per guide**	**Number of pages of exclusions per guide**	**Number of persons covered**
Debtor life, health and employment insurance	22	3	1.7	3
Travel insurance	49	The majority of these guides offer more than 5 products	8	1

This review allowed us to observe that the guides are frequently voluminous and complex. We identified three main reasons for this state of affairs.

The first reason is the use of a "policy-guide" or "certificate-guide" approach, in which all the clauses of the insurance policy or of the certificate confirming the insurance coverage are included in the guide. Accordingly, no insurance policy and no certificate, as the case may be, is given to the consumer. Although this avoids duplication of documents, it makes the guide much longer than would otherwise be the case.

It is important to point out that the insurance contract or certificate is useful for the consumer only if the latter has bought the product. The consumer may need only certain clauses of the contract in order to make an informed decision, such as those relating to exclusions. Adding multiple clauses can make the guide more complex, while burying the important items amidst other information that is less useful at the point when the insurance product is being offered.

The second reason is the use of a single guide containing the offer of several products. For example, a guide on the subject of travel insurance may offer the consumer several other types of insurance (life, disability, hospitalization, rehabilitation, baggage loss, trip cancellation, etc.), which the consumer can combine as he or she sees fit.

Given that the DWR is an exception regime, and that the insurance is being offered by a person who has neither the training nor the obligations of a certified representative, it is important that the products offered remain simple. Offering multiple products, options or features, some of which may not be relevant to the consumer, tends to make it more complicated for him or her to understand the product and compare it to others.

The third reason is the proliferation of exclusion, restriction and limitation clauses, including those pertaining to pre-existing conditions. Overall, 93% of consumers are accepted automatically. This high acceptance rate is due to the existence of these clauses, which are designed to accept the largest possible number of people due to the fact that the consumer is subjected neither to a selection process assessing the risks nor to the validation of eligibility by the insurer when he or she takes out the insurance. As a result, besides demanding a better understanding by the consumer, the proliferation and dispersal of these clauses inside the guides make the products more complex.

A survey of 373 respondents, conducted by the *Centre d'intervention budgétaire et sociale de la Mauricie*, shows how little interest consumers have in the insurance products associated with loans. They understand how important such products are, but believe that they can trust their lending institution[3]. This finding demonstrates the importance of the guide as a disclosure tool.

Moreover, the distribution guide is one of two main sources of information for the consumer, the other being the distributor. It is therefore important that the guide be provided to him or her in a timely fashion. Meanwhile, in practice, the guide is often not provided until the end of the process of purchasing the good and the associated insurance. The consumer may be pressed for time and unable to thoroughly review the voluminous information document received.

The insurance products distributed by means of the DWR regime represent 17% of all complaints declared in the province of Québec by insurers and filed with the AMF's Complaints Register, between July 1 and December 31, 2009.

[3] CENTRE D'INTERVENTION BUDGÉTAIRE ET SOCIALE DE LA MAURICIE, *Personal and Mortgage Loans and Associated Insurance*, Office of Consumer Affairs, Industry Canada, 2008.

We examined the 137 DWR-related complaints that were entered in the Complaints Register during that period, and we noted that 83% of them had to do with the claim process. We arrived at the same finding based on the 336 complaints reported by insurers in the forms completed for the year 2008.

The two reasons for complaint cited most often, and which together account for nearly 90% of claim-related complaints, were:

- refusal by the insurer to honour the claim
- the cancellation of benefits

Our research also showed that in DWR situations, for the year 2008, nearly one claim out of five was rejected, with the main reasons being as follows:

	Pre-existing conditions	**Exclusions specified in the contract**	**Ineligibility[4]**	**Other reasons**
Number of claims rejected	2,032	2,443	1,517	3,678
Proportion	21%	25%	16%	38%
	62%			

Thus, we found that nearly two thirds of rejected claims were turned down for reasons that must be disclosed in the guide or by the distributor. We also found that they were based mainly upon clauses dealing with pre-existing conditions, exclusion clauses and eligibility criteria.

If the consumer does not understand these elements, he or she may find himself or herself in trouble at a bad time, as he or she will be relying on the proceeds of the insurance which, in some cases, will be denied to him or her. This denial by the insurer, even warranted, then becomes fraught with consequences since the consumer might subsequently no longer be eligible for other insurance of the same type, or might have the pre-existing condition clauses applied to him or her. Furthermore, if the consumer is still eligible for an individual type insurance product, the latter may be subject to an exclusion endorsement or an extra premium, as the case may be. Thus, the disclosure and understanding of these factors constitute major issues for the consumer. In a DWR situation, the burden of fully understanding the product, particularly the limits thereof, lies to a large degree with the consumer; hence the importance of keeping the information simple and easily accessible.

It appears from the foregoing that the guides could be improved in order to better achieve the disclosure objectives that are desirable to properly protect consumers. It would therefore be advisable to evaluate what steps could be taken to limit the information shown in the guide to that which is essential, and to ensure that the format of the guide promotes a quick understanding of the relevant information.

[4] This heading also covers any other reason leading to the *ab initio* cancellation of the insurance contract. *Ab initio* cancellation means that the contract is cancelled retroactively, as if it had never existed, mainly due to the fact that the consumer was not eligible for the insurance product.

RECOMMENDATIONS

1. Reduce the length and complexity of the guide

In order to control and limit the quantity of information to be disclosed, a guide template should be created by the AMF. Accordingly, the guide should deal only with the following information:

- the nature of the guarantee
- a description of the protection provided
- the eligibility and insurability conditions
- the exclusions, restrictions and limitations
- the remuneration paid to the distributor
- a statement that similar insurance is available on the market
- the contact information of the consultation service maintained by the insurer
- the contact information of the AMF
- information on the contract rescission period
- the required attachments, if any

Although similar to what is currently prescribed by the existing regulation, this information is often buried amidst other points that could be of lesser importance. Moreover, it is often described in technical and legal terms. In order to be understood in the short amount of time that the consumer has to make a choice in a DWR situation, the information must be succinct, present the crucial elements quickly and effectively, and make some references to the policy, the certificate or the application form, as the case may be.

2. Limit the number of insurance products that may be offered in the same guide

Even though the proposed new format for the guide makes it short and to the point, it must also describe a product that is simple. Including multiple insurance products in the same guide does not meet the objective of a guide, which is to disclose information about a product that the consumer has already chosen. The greater the number of products offered to the consumer, the more the consumer must be guided through his or her choices. As we have seen, the distributor cannot legally play that role. Only a certified representative can do so appropriately.

Accordingly, to facilitate the consumer's understanding of the product in a DWR situation, the number of incidental aspects of the insurance product that can be discussed in a guide should be restricted. The insurance coverages should be directly linked to the nature of the risk in question.

3. Give greater prominence to the exclusion, restriction, limitation and pre-existing condition clauses

Given how important the exclusions, restrictions, limitations and pre-existing condition clauses are to the consumer, they must be clearly understood by him or her. In practice, these items are often described in legal and technical terms designed to be as exhaustive as possible. While that approach is suitable for a contract, it is not appropriate in a guide. Instead, these items should be described in a sufficiently concise and simple manner to draw the consumer's attention to a situation that might concern him or her and, if need be, refer him or her to the contract.

To make it easier for the consumer to find this information, it should be grouped together in the same part of the guide, in a distinct visual format.

In order for the reference to be effective, the guide should include a warning to the consumer about the importance of reviewing this information, as well as the consequences that could ensue in the event of a loss.

4. Require that confirmation of insurance be separate from the guide

The distribution guide is not intended to be an integral part of the insurance contract. It should therefore not be used as a "confirmation", and thus serve as a substitute for the insurance certificate or policy, which confirms that the consumer is covered by the insurance[5].

Section 444 of the Act requires a distributor offering a consumer, upon granting a loan, debtor life, health and employment insurance to provide him or her with a confirmation of insurance from the insurer within 30 days of the application to purchase such insurance. The scope of this section must be extended to all products that are eligible for the DWR regime. Consumers would be better protected if all products offered by means of DWR were subject to this requirement, and if that confirmation were personalized.

5. Facilitate access to the guide

Since, in a DWR situation, the insurance product is bought incidentally to the purchase of a good, the consumer is not offered access to the distribution guide until after he or she has made the decision to purchase the good, and therefore has just a few minutes in which to make up his or her mind about the insurance being offered.

To facilitate access to the guide at any time, the AMF proposes to make the guides available on its website. Consumers would then be able to consult them at their leisure, and compare the products available on the DWR market before they even acquire the good in question.

II. Rescission of the contract

FINDINGS

In a DWR situation, an insurance contract is sold in conjunction with the acquisition of a good. Since the consumer most probably has not considered, or given careful thought to, acquiring an insurance product, it is possible that he or she agrees to buy an insurance product that he or she does not need, has misunderstood or could acquire in a different way.

The Act allows for a period of 10 days during which the consumer may request cancellation of the insurance coverage, free of charge (known as "rescission").

This 10-day period is all the more important since, as we have discussed earlier, the guides in their current format do not always properly fulfill their disclosure role, which is to provide consumers with all the relevant information about the insurance product being offered in a DWR situation.

[5] The confirmation of insurance does not bind the insurer to accept any future claims. Its purpose is to confirm to the consumer that he or she is eligible for the product being offered, and that he or she meets the insurability criteria, as applicable.

Based on an analysis of 466 calls relating to DWR situations received at the AMF's Information Centre, we find that consumers are generally not aware of the existing rescission process, or its duration.

On this point, a working group formed by the Canadian Council of Insurance Regulators (CCIR) concluded that the conditions surrounding the incidental selling of insurance, as well as the cooling-off period provided for in the legislation, did not always enable the consumer to properly determine whether the proposed product was suitable to his or her situation.[6]

In the United Kingdom, the Financial Services Authority ("FSA") has incorporated a rule in the *Insurance Conduct of Business Handbook* to extend the cancellation period to 30 days for credit insurance products designated as *Payment Protection Insurance*[7], with no penalty. In addition, in the credit insurance report issued by the Consumer Council of Canada[8] in 2009, one of the recommendations pertained specifically to the extension of the insurance contract rescission period to 30 days.

RECOMMENDATION

6. <u>Extend the insurance policy rescission period from 10 to 30 days</u>

The AMF believes that the consumer should have sufficient time to reconsider the purchasing decision he or she has made and, if need be, to verify whether a "conventional" product would suit him or her better.

For these reasons, it would be advisable to extend the rescission period to 30 days, as some insurers already do.

III. Supervision of distributors

FINDINGS

In DWR situations, distributors are one of the two main sources of disclosure of information to the consumer, the other being the distribution guide. The Act imposes specific obligations on distributors, including:

- see to it that their personnel are sufficiently familiar with the guide
- describe the nature of the product and its exclusions to the consumer
- give the consumer a copy of the guide prior to selling the product
- inform the consumer as to the procedure for presenting a claim and time frames to do so
- give the consumer the notice of cancellation provided for by the regulation and, in the case of insurance related to a loan, give the latter a confirmation of insurance within 30 days of his or her adhesion

The previous findings concerning complaints and rejected claims also apply here. Thus, it seems that in the current state of affairs, the distributors do not always play an appropriate role with respect to the disclosure of relevant information to consumers.

[6] CANADIAN COUNCIL OF INSURANCE REGULATORS AND THE CANADIAN INSURANCE SERVICES REGULATORY ORGANIZATIONS, *Incidental Selling of Insurance Report,* November 2008, P. 8 [electronic resource], online < http://www.ccir-ccrra.org/en/init/ISI/ISI_Nov2008EngFinalReport.pdf > (viewed on February 9, 2010).
[7] These products are equivalent to debtor life, health and employment insurance.
[8] Ken WHITEHURST and Howard J. DEANE, *<u>Creditors Insurance - Are Consumers Being Well Served?</u>*, prepared for Office of Consumer Affairs - Industry Canada, Consumers Council of Canada, March 31, 2009, p. 10.

The Act requires the insurer to supervise its distributors, and the distributor to supervise its employees.

Our research enabled us to identify certain best practices in the industry with respect to the training of distributors, including the following:

- Some insurers assume responsibility, either directly or through a specialized third party, for the training of distributors' employees.
- Some insurers have implemented examinations to validate the understanding of trained employees.
- Some call centres provide training using software, produce weekly reports, use call scripts and listen in on telephone conversations.

Although these practices are necessary, we find that distributors are monitored by the insurers or by their TPA in only 15% of cases.

However, in compiling the complaints received at the AMF Complaint Examination and Assistance department, we found that 45% of the complaints filed in 2008 and 2009 were related to underwriting. They had to do with the ineligibility of consumers and obvious errors on the part of the distributors.

Furthermore, the lists of distributors filed with the AMF by the insurer often include businesses whose activities bear no relation to the insurance product being sold. Yet, the Act requires the insurance product to be related to the good being sold by the distributor; this condition cannot be complied with if the business' activity is not relevant to the insurance product being proposed[9].

As we have seen, the Act calls for the insurer to take all appropriate steps to ensure that its distributors are sufficiently familiar with the insurance product to which the guide pertains. Thus, quality control over the information conveyed by the distributors may be achieved through training and supervision of those distributors. Unfortunately, we found that the measures taken by insurers were varied and unequal across the industry.

RECOMMENDATIONS

7. Hold the insurers accountable for their distributors' fulfillment of their obligations

Given that the distributors are not individuals holding certificates issued by the AMF in the field of damage insurance or insurance of persons, that they are not supervised by the *Chambre de l'assurance de dommages* or by the *Chambre de la sécurité financière*, and that they offer insurance products on behalf of an insurer, the latter should be more accountable for the failures of its distributors.

Holding the insurers accountable for their distributors' fulfillment of their obligations will require the insurers to take the necessary steps to ensure that their distributors comply with the legislation, namely by adopting supervision procedures.

[9] For example, the AMF observed that some swimming pool and outdoor furniture retailers offered car loan insurance products.

8. Inspect the distributors

Since the distributors have specific obligations under the Act, the AMF should develop a specific inspection program to verify that they are fulfilling those obligations.

These inspections, together with increased supervision by the insurers, should improve the distributors' compliance level, particularly with respect to the delivery of guides, the disclosure of important information and, if applicable, the disclosure of their remuneration.

9. Create a distributors registry

The creation of a public registry of distributors should enable consumers to review the list of products that the distributors can offer, once the distribution guides are posted online (Recommendation no. 5). This would enable consumers to make sure they are dealing with an authorized distributor and could notably prevent unauthorized distributors from collecting premiums, as has happened elsewhere.

10. Require that insurers control the incidental nature of the sale of insurance

In view of the fact that the distributor offers, in an accessory manner, an insurance product related to a good, the insurer should ensure that the insurance product that is offered is consistent with the good being sold by the distributor.

Let's keep in mind that the insurer must also validate whether distributors acting as group policyholders are qualified to act in that capacity.

IV. Disclosure of distributors' remuneration

FINDINGS

The Act requires distributors to disclose to consumers any remuneration received that exceeds 30% of the cost of the product. On April 9, 2001, the *Bureau des services financiers* ("BSF"), one of the AMF predecessors, issued its *Directives concerning the obligations of disclosure of distributors*[10] in its Bulletin. The BSF then made it clear that distributors offering more than one insurance product for the same good must disclose to consumers the remuneration they receive for each of those products, if it exceeds 30% of the cost of any one of those products.

Furthermore, although the Act is silent as to the form that the remuneration and the disclosure must take, the Bulletin clearly indicated that any quantifiable amount received by the distributor pursuant to the distribution of an insurance product must be taken into account in calculating the remuneration. As to the form of disclosure, the only indications given by the BSF were that it may be verbal or in writing and expressed either as a percentage or as an absolute amount. The distributor must disclose its exact remuneration (e.g. 49%), and not just the fact that it exceeds 30%. Furthermore, in a judgment rendered on August 16, 2004, the Superior Court ruled that the

[10] *BUREAU DES SERVICES FINANCIERS*, Directives concerning the obligations of disclosure of distributors, *Application of sections 431 and 433 of the Act respecting the distribution of financial products and services (R.S.Q., c. D-9.2)*, Bulletin No. 13, April 9, 2001, [electronic resource], online: <http://www.lautorite.qc.ca/userfiles/File/bulletins/anciens%20Bulletin%20BSF/bulletin-13-avril-ang.pdf> (site viewed on February 16, 2010).

distributor was obliged to disclose all of the remuneration it had received, including that paid to all the businesses affiliated with it[11].

One might question why a distributor must disclose its remuneration, while a certified representative is not required to do so. Certified representatives have taken training, as they are obliged to determine the consumer's insurance needs and the products that might suit him or her. Moreover, they have legal and ethical obligations that are monitored on a regular basis. They must act in the consumer's interest.

As for distributors, they have no obligation to know the consumer's needs, or to determine whether the product is suitable. The distributors' activities are not in the field of insurance. Consequently, their motivation for offering insurance products is likely to be linked to the remuneration they receive.

We must keep in mind that the insurance product is being offered to the consumer in conjunction with his or her acquisition of an entirely different product. In this situation, the consumer does not necessarily have in mind all the insurance coverage he or she already has, or any idea of the reasonable cost of an insurance product. There is therefore a risk that the consumer acquires a product that he or she does not need, or pay too much for it.

The Act calls for the distributor to inform the consumer that similar insurance is available on the market. That obligation, combined with the obligation to disclose the remuneration paid to the distributor in cases where it exceeds 30%, may lead the consumer to think twice about whether it is necessary to acquire the insurance product, or at least to consider doing some price comparisons.

This requirement of disclosing the distributor's remuneration and its issues is not found only in Québec. In the United Kingdom, the Financial Services Authority (FSA) carried out some mystery shopping exercises giving rise to the offering of credit insurance products, and found that the remuneration levels and structures, as well as the sales targets, could promote bad sales[12]. Moreover, the Office of Fair Trading found that, on the one hand, consumers were unfamiliar with these products, their prices and their characteristics and that, on the other hand, they did not shop around, which bolstered the advantage of the point of sale and made comparisons more difficult[13]. This finding on the advantage of the point of sale pushed the Competition Commission, to which the matter had been referred, to recommend in its final report, issued in January 2009, that the selling of credit insurance products be prohibited at the time of offering credit and in the next seven days thereafter[14].

Those same agencies found that the commission rates paid by insurers to the intermediaries appeared to be high compared to the rates paid for similar products. Moreover, those agencies believe that the distributors reap substantial profits.

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[11] *Formule Pontiac Buick inc. c. Québec (Bureau des services financiers),* 2004 CanLII 7239 (Qc C.S.), confirmed in appeal (2005 QCCA 1027).

[12] FINANCIAL SERVICES AUTHORITY, *The Sale of Payment Protection Insurance. Results of Thematic Work* (November 2005), online: <http://www.fsa.gov.uk/pubs/other/ppi_thematic_report.pdf> (site viewed on February 9, 2010).

[13] OFFICE OF FAIR TRADING, *Payment Protection Insurance. The OFT's Reasons for Making a Market Investigation Reference to the Competition Commission* (February 2007), online: <http://www.oft.gov.uk/shared_oft/reports/financial_products/oft899(1).pdf> (site viewed on February 9, 2010).

[14] COMPETITION COMMISSION, *Market Investigation into Payment Protection Insurance* (January 29, 2009), online: <http://www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/542.pdf> (site viewed on February 9, 2010).

In Canada, in its report entitled *Creditors Insurance – Are Consumers Being Well Served?*[15], the Office of Consumer Affairs finds that consumers would often be better served by buying temporary life or disability insurance rather than credit life and disability insurance, provided that they are eligible for such a product and prepared to shop around. In fact, their research shows that the price of these types of insurance is often equal to, or lower than, that of credit insurance.

Moreover, the Financial Consumer Agency of Canada writes, in a publication on credit balance insurance[16], that it is usually more expensive than other forms of life or disability insurance. It would not be appropriate if the consumer already had other life insurance that could help him or her pay his or her debts in the event of death or disability, or if he or she had another source of income that would be likely to cover the minimum payments on his or her credit card accounts.

Supervision of remuneration disclosure by distributors presents many challenges, particularly in view of the following:

- commercial issues relating to competition among insurers
- commercial issues relating to competition among distributors
- the difficulty of stating the remuneration in a guide, as the rate can vary from one distributor to another
- since the disclosure may be made verbally, it is difficult to monitor it at the source

As mentioned a little earlier, for 40% of the products sold, the distributor's average remuneration is 49%, thus above the threshold of 30% which requires disclosure to consumers.

The information gathered from certain cases leads us to believe that disclosure measures are not well understood, are often not applied and that they are sometimes even bypassed by the industry (for example, by creating management companies to which dividends are paid, by creating inoperative insurance firms in order to split commissions, by transferring cases to reinsurers belonging to the same financial group, by multiplying the intermediaries, or by increasing the remuneration for a related product, etc.).

Obviously, from a competitive standpoint, disclosing remuneration is not to the distributor's advantage, especially if it is around the 50% mark. Consequently, if the fulfillment of this obligation is not clear, or not controlled, the tendency will be to omit to disclose.

RECOMMENDATION

11. <u>Disclose the distributor's remuneration, whether direct or indirect, in all cases and in writing</u>

Disclosing the remuneration in writing makes it possible to monitor how it is done.

Eliminating the 30% threshold beyond which disclosure is compulsory removes any ambiguity concerning the manner of calculating the remuneration, and makes the distributors' disclosure obligation unmistakable. At the same time, abolishing that threshold makes it pointless to create structures to bypass the obligation to disclose remuneration.

[15] *Creditors Insurance – Are Consumers Being Well Served?*, op.cit., note 8, on page 9.
[16] GOVERNMENT OF CANADA, Financial Consumer Agency of Canada, *Credit Balance Insurance* [Electronic resource], rev. in 2009, online: http://www.fcac-acfc.gc.ca/eng/publications/CreditCardsYou/pdfs/CreditBalance-eng.pdf (site viewed on February 9, 2010).

The AMF is aware that the disclosure of remuneration has significant competition implications, and therefore proposes three solutions. That said, for each of the proposed solutions, the AMF believes that distributors should be required to:

- bring the written disclosure of distributor's remuneration to the consumer's attention
- have the consumer initial the section that contains the disclosure of remuneration
- store a copy of the document in the customer's file, showing that disclosure has been made

Proposal 1

The first solution that the AMF is proposing is to disclose the distributor's remuneration in the guide.

This solution offers the following advantages:

- The insurer establishes a single rates and remuneration structure for all distributors offering the same product.
- Stating this remuneration in the guide ensures its disclosure.
- The price of the product (the premium) is set according to the risk that is actually borne by the insurer, and not based on the remuneration that each distributor has negotiated with the insurer.
- Posting the guides on the AMF's website (Recommendation no. 5) would enable consumers to compare the remuneration paid to, as well as the products offered by, the various distributors.
- This practice can be applied to any type of product offered through DWR.

This solution has the following drawbacks:

- Consumers no longer benefit from competition between distributors that offer the same product from the same insurer.
- Instituting identical remuneration for all distributors might encourage the adoption of alternative methods to compensate certain distributors.

Proposal 2

The second proposed solution is to develop a form, prescribed by the AMF, whereby all forms of remuneration paid to distributors would be disclosed to consumers. This form would be handed to the consumer and could be worded more or less as follows:

> The cost of the insurance, excluding direct and indirect remuneration to the distributor, is $XXXX.
>
> The distributor's remuneration is $XXXX.
>
> These two amounts make up the total premium of $XXXX that is charged to you for this insurance product.

This solution offers the following advantages:

- It allows for different remuneration depending on distributors, which promotes competition and thus better prices.

- It can reflect the various forms of remuneration that a distributor may receive, thus promoting transparency.
- Transparency makes it pointless to set up corporate structures intended to disguise the forms of remuneration.
- It promotes compliance on the part of the distributor.
- This practice can be applied to any type of product offered through DWR.

This solution has the following drawbacks:

- It increases the number of documents to be given to the consumer, since the information cannot be disclosed in the guide.
- Since the total remuneration must be disclosed from the outset, this approach is not conducive to setting up contingent remuneration programs.

Proposal 3

In the specific situation of DWR, the distributor’s remuneration could be excluded from the premium paid to the insurer and paid directly by the consumer, separately from the insurance. In this way, the insurer would offer its product at a cost that does not include any remuneration and the distributor would charge its fees in a distinct and transparent manner.

This solution offers the following advantages:

- The insurer sets a single price for its insurance product which applies to all distributors.
- The consumer receives automatic and certain disclosure of the remuneration received by the distributor, since the fees are charged to him or her directly.
- These fees can easily be changed.
- This practice can be applied to any type of product offered through DWR.

This solution has the following drawback:

- The insurer no longer controls the overall cost of its product, as it does when it includes the remuneration.

The AMF is presenting three solutions to ensure full disclosure, in writing, of the distributor’s remuneration, in all circumstances. The AMF believes that transparency is called for. Consumers should know the economic interest of the party offering them an insurance product, given that distributors, contrary to certified representatives, do not have the required training or the obligation to analyse the client’s needs and to determine the suitability of the product they are proposing.

That being said, the AMF welcomes proposals of other solutions that would meet the same goal.

V. Financing of single premiums

FINDINGS

In its research, the AMF found that in the case of insurance products with a single premium that was financed, it was difficult for consumers to evaluate the real cost of the premium, because interest was added to it.

On this subject, the *Centre d'intervention budgétaire et sociale de la Mauricie*, in its report on insurance linked to personal and mortgage loans[17], concluded that since the cost of insurance is not calculated separately, or presented appropriately, consumers are unable to determine the real cost of the insurance and to compare it. It is also difficult for consumers to include it in a monthly budget.

It is also a fact that consumers are unfamiliar with the methods used to calculate the reimbursement of such premiums in the event the insurance contract is cancelled. Indeed, the reimbursement does not correspond to the premium paid, prorated according to the number of months that have elapsed.

These methods of calculating the reimbursement of premiums in the event the insurance contract is cancelled (e.g. the "Rule of 78" + administration fees) can compromise the cancellation process and render the consumer captive.

This conclusion is similar to that which, in the United Kingdom, the FSA arrived at following mystery purchases of credit insurance products[18]. In the case of single premiums, the FSA found that the reimbursement practices reflected neither the cost nor the risk profile of the consumer when these products were cancelled.

In light of that finding, the FSA forged an agreement with the industry that this type of product would no longer contain a "no reimbursement" clause[19]. Subsequently, in 2009, the Competition Commission published its final report on so-called *Payment Protection Insurance products*[20] and planned to prohibit single-premium policies in the United Kingdom.

RECOMMENDATION

12. <u>State the cost of the single premium insurance product in the guide, as well as the terms of reimbursement in case of cancellation</u>

As the FSA indicated in its *Insurance Conduct of Business Handbook*, the AMF believes that the presentation of information and the literature given to the consumer, i.e. the guide, should enable him or her to understand the total cost of the insurance product as well as the additional cost pertaining to the financing of the premium.

The guide should also inform the consumer about the terms of reimbursement of the premium paid in the event the contract is cancelled.

VI. Use of telemarketing

FINDINGS

As mentioned earlier, 73% of the insurance products offered through DWR pertain to debtor life, health and employment insurance. Of those, 22%[21] offer credit card balance insurance. Furthermore, as part of its research, the AMF identified, on the website of the Financial

[17] CENTRE D'INTERVENTION BUDGÉTAIRE ET SOCIALE DE LA MAURICIE, op.cit., note 3, page 5.
[18] FINANCIAL SERVICES AUTHORITY, op.cit., note 12, page 12.
[19] The "no reimbursement" clause is a clause whereby, in the event the insurance policy is cancelled for any reason whatsoever, the consumer receives a very tiny reimbursement of premiums — almost nothing.
[20] COMPETITION COMMISSION, op.cit., note 14, page 12.
[21] 44 guides out of 203 reviewed.

Consumer Agency of Canada[22], 668 travel insurance and "purchase protection and extended warranty" products associated with credit or debit cards potentially offered in Québec.

In the majority of cases, these products are offered through call centres. Credit card-holders are often solicited by telephone, several weeks, or even months or years, after acquiring their credit card, and offered various insurance products associated with the card.

It is interesting to note that in February 2009, the CBC network's Marketplace television program asked the EKOS firm to conduct a survey of 1,036 Canadians about the balance insurance offered by credit card issuers. Here are some of the highlights of that survey:

- 23% of respondents claim they did not receive appropriate explanations.
- 22% of those who bought the insurance claim they were not told that it was optional.
- 51% of those who bought the insurance say that it was never explained to them that the insurer would not pay the entire balance in the event of loss of employment or disability.
- 56% of those who bought the insurance say that it was never explained to them that the insurance did not cover pre-existing conditions.

The DWR regime is ill-suited to telemarketing. In a telemarketing situation, the purchase is generally made during a single call of a generally short duration; it is therefore difficult to give the consumer a copy of the guide in a timely manner, which contravenes the Act. Instead, the guide is sent to the consumer by mail, along with the insurance certificate, as applicable. Besides contravening the law, the guide does not fulfill its disclosure role in this situation. We must therefore find avenues of solution to remedy this state of affairs. Furthermore, in this situation, the application of the rescission period is problematic, since, in some cases, it may elapse before the consumer even receives the documents related to the product he or she has bought.

RECOMMENDATIONS

It is important to distinguish the DWR regime from telemarketing, as the latter is merely a method of contacting the customer. The offering of an insurance product using telemarketing does not automatically ensure said product to become subject to the DWR regime. Indeed, even though the product may be offered via telemarketing, the involvement of a certified representative subject to the supervision rules of the conventional regime may be required.

In cases where the product that is being offered qualifies for the DWR regime, we believe it is appropriate to adapt the obligations contained in Title VIII of the Act to that form of communication, while complying with the principles and directives that apply to the supervision of telemarketing in general.

13. Prepare call scripts that meet DWR requirements

Given that, in this situation, the distribution guide cannot be given to the consumer in a timely manner, call scripts containing the disclosure items called for in the DWR regime should be used by the distributors. Said scripts should be filed with the AMF along with the guide.

14. Extend the rescission period of the insurance contract

The duration of the rescission period should reflect the fact that in a telemarketing situation, the consumer has no literature in hand when buying the insurance product. Therefore, he or she

[22] www.fcac-acfc.gc.ca.

cannot consult it to assess the wisdom of his or her purchase decision. In this context, recommendation no. 6 applies.

CONCLUSION

Our general finding is that there is a need for improvement in the supervision of Québec's DWR market, in particular to make the guide simpler and to better supervise the distributors. Since the distribution guide and the distributors are the main sources of information based on which the consumer can evaluate whether or not the insurance product is right for him or her, it is important that they play their role to their full extent. We believe that our recommendations appropriately resolve the problems associated with the six main issues identified.

Before implementing these recommendations, the AMF welcomes comments from any interested party, and invites consumer associations as well as the industry players concerned by these recommendations to file their briefs. **To this effect, please note that unless otherwise requested, the comments will be posted on the AMF website**.

Thus, any person who wishes to make comments shall send them in writing, **before February 25, 2011**, to the following:

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LIST OF RECOMMENDATIONS