

Notice regarding replacement insurance - Non-compliant practices

Certain practices set up by stakeholders involved in offering Q.P.F. No. 5 – Complementary Insurance for Damage Caused to Insured Vehicle Form (*Replacement Insurance*) (the "replacement insurance") have come to the attention of the *Autorité des marchés financiers* (the "Authority").

The Authority is of the opinion that these practices could violate the requirements set out in *An Act respecting insurance*, CQLR, c. A-32 (the "Insurance Act"), *An Act respecting the distribution of financial products and services*, CQLR, c. D-9.2 (the "Distribution Act") and various Notices published by the Authority, in particular the following:

- *Avis relatif à l'offre de produits d'assurance afférents à un véhicule* (Notice on the distribution of insurance products relating to a motor vehicle) (April 30, 2010) – in French only;
- *Avis relatif à l'assurance de remplacement* (Notice related to Replacement Insurance) (July 23, 2010) – in French only;
- *Avis relatif à l'indication de clients en application de la Loi sur la distribution de produits et services financiers* (Notice on client referrals under *An Act respecting the distribution of financial products and services*) (October 8, 2010) – in French only;
- *Notice regarding Q.P.F. No. 5 – Complementary Insurance for Damage Caused to Insured Vehicle Form (Replacement Insurance)* (June 7, 2012).

Insurers or persons through whom the insurer's products are distributed – such as a certified representative or a distributor under Title VIII of the Distribution Act (automobile dealers and used car dealers) – must cease such practices immediately.

The following list is not exhaustive, and the Authority reserves the right to take steps to prevent any other non-compliant practice.

Non-compliant distribution practices

1. The distributor does not disclose to the client the remuneration he receives for the sale of the product when it exceeds 30% of its sale price

The distributor must disclose, in the form of a percentage or amount, the remuneration paid to him for the sale of an insurance product when it exceeds 30% of the product's sale price. Moreover, the Authority is of the opinion that the amount of remuneration should be disclosed in writing as part of a sound distribution practice.

This disclosure requirement is even more important when the distributor's remuneration for the sale of replacement insurance reaches, as can sometimes be the case, 60% of the amount of the premium charged to the client.

2. The distributor does not offer the consumer both compensation options

The distributor must offer the client the following compensation options: the replacement of the vehicle through the named dealer (option 1) or the payment of an indemnity to replace the vehicle through a dealer of the client's choosing (option 2). The distributor must allow the client to choose the most suitable option.

3. The balance of a previous debt is added to the purchase price of the new vehicle

On June 7, 2012, the Authority published the *Notice regarding Q.P.F. No. 5 – Complementary Insurance for Damage Caused to Insured Vehicle Form – Replacement Insurance* in order to put a stop to a non-compliant practice. This practice consisted in indicating in the purchase contract, long-term lease or contract of leasing and in the replacement insurance policy, an amount as “purchase price” which includes both:

- the price charged by the dealer for a new or used automobile;
- the outstanding balance related to the trade-in or damaged automobile (in the event of total loss).

Because the purchase price is generally used to determine the value of the replacement vehicle in the event of total loss and the insurance premium, indicating a price that is higher than the dealer's actual price distorts the replacement insurance product and could even be an incentive for fraud. The Authority is concerned that this practice might increase the consumer's premium and the remuneration received by the distributor.

4. The distributor compares the replacement insurance to the replacement cost endorsement

Distributors may not compare two insurance products since, in doing so, they are effectively offering the client insurance advice, which is an act reserved for certified insurance representatives.

For example, the distributor must not, under any circumstances, give or present to a client a table comparing replacement insurance and Q.E.F. No. 43 (A to F) – *Change to indemnity* (the “replacement cost endorsement”). Such a table may, however, be used in training courses for distributors.

5. The distributor offers the client Q.P.F. No. 1

Distributors may not offer a consumer Q.P.F. No.1 - *Owners' Form* (“Q.P.F. No. 1”) and is not authorized to gather personal information in order to obtain a quote for a Q.P.F. No. 1.

On October 8, 2010, the Authority issued the *Avis relatif à l'indication de clients en application de la Loi sur la distribution de produits et services financiers (Notice on client referrals under An Act respecting the distribution of financial products and services)* in order to define and set limitations on client referrals. In the Notice (in French only), the Authority provides examples of acts that are not permitted in a context of client referrals:

- Gather personal information in order to obtain a quote;
- Complete an application for an insurance quote on behalf of a client or help the client complete such an application;
- Complete an insurance application on behalf of a client or help the client complete such an application;
- Exert pressure or induce a client to purchase insurance from the particular representative or registered person indicated;
- Provide the client with any insurance advice.

6. A copy of the distribution guide is not given to the client prior to the sale of the insurance product by the distributor

Under section 435 of the Distribution Act, a distributor must give the client a copy of the distribution guide before selling him an insurance product. The purpose of the distribution guide is to help the client evaluate the insurance product and determine whether it meets his needs, since he is not in the presence of an insurance representative.

7. The distributor requires the client to purchase replacement insurance

The distributor may not subordinate obtaining automobile loan financing or a preferential rate to the purchase of replacement insurance. Section 439 of the Distribution Act provides as follows:

“A distributor may not subordinate the making of a contract to the making of an insurance contract with the insurer specified by the distributor.
The distributor may not exercise undue pressure on the client or use fraudulent tactics to induce the client to purchase a financial product or service.”

8. In the event of a partial loss, the distributor requires the client to have his vehicle repaired by his dealership

In the event of a partial loss, the client may always choose the repairer, regardless of the replacement insurance option chosen.

9. The distributor sells replacement insurance to a client who holds a replacement cost endorsement

The distributor must ask the client whether he is already covered by insurance that offers similar protection to replacement insurance. Similarly, the insurance representative must verify whether the client already holds replacement insurance.

The Authority considers that replacement insurance and the replacement cost endorsement offer similar coverage and that a client should hold only one of these products.

In addition, the distributor may not advise the client to terminate his replacement cost endorsement in order to sell him replacement insurance.

10. The insurance representative intentionally does not propose the replacement cost endorsement when selling Q.P.F. No. 1, so that the distributor can sell the client replacement insurance

Under section 27 of the Distribution Act, insurance representatives are required to propose the insurance product that best meets the client's needs.

Reminder to insurers

The Authority is of the opinion that the absence or inadequacy of policies, procedures and controls put in place by insurers to oversee the distribution of replacement insurance may contribute to the emergence and persistence of the non-compliant practices identified.

The Authority reminds insurers that, in accordance with section 420 of the Distribution Act, they must take all appropriate steps to ensure that their distributors are sufficiently familiar with the replacement insurance product.

Moreover, section 222.2 of the Insurance Act provides that every insurer must adhere to sound commercial practices. These practices include properly informing persons being offered a product or service and acting fairly in dealings with them.

The *Sound Commercial Practices Guideline* communicates the Authority's expectations regarding expected results pertaining to the fair treatment of consumers. In particular, it reminds insurers that they should ensure compliance process control for the supply of products and services, regardless of whether or not the network offer is independent of them. The Authority expects that incentives will not affect the fair treatment of consumers.

In addition, section 222.1 of the Insurance Act states that every insurer must adhere to sound and prudent management practices.

The *Outsourcing Risk Management Guideline* stipulates that insurers remain responsible for the compliance of outsourcing arrangements with the legal and regulatory requirements applicable to outsourced activities even where the execution and management of these activities are ensured by service providers. Therefore, where an insurer decides to outsource the compliance management of its distribution network to a program administrator, it must set up mechanisms to ensure that the distribution activities comply with the legal and regulatory framework.

Clarification

The Authority intends to take the necessary measures to put an end to any practice that is not in compliance with the Insurance Act and the Distribution Act. As such, it may impose an administrative sanction or take penal proceedings against any person who fails to comply with these Acts. It may also order an insurer to cease distributing an insurance product through distributors.

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