

CCIR

June 3, 2005

Dear stakeholders:

The Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO) are pleased to release a consultation paper entitled *Relationships Between Insurers and Sales Intermediaries*. The consultation paper is being released today for review and comment by all stakeholders and other interested parties.

The consultation paper was prepared by the CCIR / CISRO Industry Practices Review Committee (IPRC). The IPRC was formed in October of 2004 to ensure a coordinated national approach to the regulators' review of insurance practices regarding the relationship between intermediaries and insurance companies.

For the first phase of its review, the IPRC developed a risk-based market conduct assessment questionnaire to obtain information from insurers about their relationships with brokers, agents, and other sales intermediaries in Canada. The consultation paper has been developed from the responses to these questionnaires that were sent to property and casualty (P&C) and life and health (L&H) companies in November and December 2004 respectively. Summaries of the responses to both the P&C questionnaire and the L&H questionnaire are included in the consultation paper.

As part of the review, the IPRC has been considering the impact various aspects of the insurer and sales intermediary relationship may have on consumer confidence. It is also exploring possible policy options for additional regulatory measures that may be required to enhance consumer protection.

The next phase in the review involves soliciting stakeholder comments on the issues discussed in the consultation paper. It is important to note, however, that none of the approaches outlined in the consultation paper should be construed as the official position of any provincial, territorial or federal government or agency.

The IPRC welcomes the comments, suggestions and ideas of consumers, insurance industry stakeholders and any other interested parties regarding the issues described in the consultation paper. A copy of the consultation paper can be found on the CCIR website (www.ccir-ccrra.org). The IPRC looks forward to receiving your submissions by August 3, 2005.

Canadian
Council of
Insurance
Regulators

Conseil
canadien
des responsables
de la réglementation
d'assurance

Electronic submissions would be preferred. Please note that CCIR and CISRO intend to publicly release all submissions received pursuant to this consultation process by posting them on the CCIR web site.

All submissions should be forwarded to:

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After collecting stakeholders' comments and suggestions, the IPRC may recommend that CCIR and CISRO propose to governments the policy options described in this paper, or other options proposed by stakeholders during the consultation. Following the consultation process, individual provincial and territorial insurance regulators will review the stakeholder input with their respective governments to determine what action, if any, is required.

Yours sincerely,

Original signed by

Michael Grist
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**THE CANADIAN COUNCIL OF INSURANCE REGULATORS
AND
THE CANADIAN INSURANCE SERVICES REGULATORY
ORGANIZATIONS**

INDUSTRY PRACTICES REVIEW COMMITTEE

**RELATIONSHIPS BETWEEN INSURERS AND SALES INTERMEDIARIES
CONSULTATION PAPER**

June 3, 2005

Ce document est également disponible en français.

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EXECUTIVE SUMMARY

What is the Issue?

Since late 2004, a number of U.S. regulators and state governments have investigated and taken legal action against a number of insurers, brokerages and individuals, alleging fraudulent, coercive and dishonest practices in the sale of insurance products. These practices include the alleged rigging of bids for insurance and concerns about the payment of contingent commissions and other sales incentives.

The Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO), which are associations of insurance regulators and of insurance intermediary licensing and regulatory authorities in Canada, decided to conduct a review of the relationship between insurers and insurance sales intermediaries (such as brokers and agents). The main objective of this review was to determine if issues similar to those in the U.S. could arise in Canada, and to identify opportunities to enhance public confidence in the Canadian insurance marketplace.

In October 2004, CCIR and CISRO established the Industry Practices Review Committee (IPRC) to examine the financial relationships between insurance companies and their sales intermediaries (e.g. contingent commissions, ownership and financial links, and sales incentives) that have the potential for creating conflicts of interest. The main tool for the IPRC review was a detailed market conduct questionnaire for insurers. The questionnaire examined various aspects of the relationship, including the payment of contingent commissions, sales incentives and ownership linkages and focused on the corporate governance issues of insurers, including the existence of policies and the monitoring and approval of policies.

Concurrent with this exercise, the Registered Insurance Brokers of Ontario (RIBO) developed its own questionnaire that was distributed to Ontario licensed property and casualty (P&C) insurance brokers. The RIBO survey requested information on markets, volumes and direct or indirect financial interests in the brokerage by an insurer, including share ownership and/or loans made by insurers. It was intended to complement the IPRC's review and add context to discussions on the practices and financial arrangements between P&C brokers and insurance companies. Concurrent with the release of this consultation paper, RIBO is releasing a report on its survey, which is available on the RIBO website (www.ribo.com).

In Québec, the Autorité des Marchés Financiers (AMF) developed questionnaires for insurance companies and sales intermediaries licensed in Québec. Where compatible, responses from insurers received by the AMF have been included in the IPRC's questionnaire results reports. On April 14, 2005, the AMF released a report entitled, *Commercial Practices in the Québec Damage Insurance (Property & Casualty) Brokerage Sector*, which is available on the AMF website (www.lautorite.qc.ca/accueil.en.html).

The AMF is expected to undertake a public consultation process on proposed regulatory options. The consultation is scheduled for the beginning of September, 2005. The related documentation will go out to stakeholders in early Summer 2005. The results of the consultation will be compared to those of the CCIR and CISRO at the CCIR Fall meeting in an effort to harmonize policy approaches across jurisdictions in Canada. The AMF also intends to analyze the Life and Health (L&H) insurance industry. The AMF has indicated that it will send a complementary questionnaire to intermediaries in the L&H sector.

The purpose of this paper is to outline the findings of the market conduct questionnaires, and to ask stakeholders for feedback on possible new regulatory responses.

Summary of Findings

General Findings:

- Most insurers have written policies and procedures in place governing compensation to brokers, agents, and other sales intermediaries.
- No evidence of any illegal insurance related activity was found. Regulators continue to monitor the marketplace and will take any action necessary if illegal activity is alleged or detected.
- The IPRC believes that some current business practices may contribute to a perception of or actual conflicts of interest in the marketplace. At issue is the appearance to a reasonable, informed, third party that bias exists in the course of providing advice to consumers due to a conflict of interest or potential conflict of interest. This may have a negative impact on consumer confidence in the insurance marketplace.

Findings Specific to the P&C Insurance Questionnaire:

- The majority of companies use brokers to sell their insurance policies.
- Insurance companies use standard contracts with the brokers that undertake to sell insurance on the company's behalf.
- More than two-thirds of insurers in Canada offer contingent commissions to their agents or brokers.
- The use of non-monetary sales incentives (e.g. learning retreats, workshops and golf tournaments) appears to be minimal with a few exceptions.
- The majority of insurance companies have policies and procedures in place to mitigate the potential for conflicts of interest.
- More than half of the companies report having loans, ownerships and other similar financial relationships with sales intermediaries.

Findings Specific to the L&H Insurance Questionnaire:

- The majority of companies use career agents, agents (managing general agents, associate general agents and personal producing general agents) and brokers to sell their insurance policies.
- Insurance companies use standard contracts with the career agents, agents and brokers that undertake to sell insurance on the company's behalf.
- The use of sales incentives, including non-monetary sales incentives paid to agents and brokers (e.g. learning retreats, workshops and golf tournaments) appears to be universal.
- All L&H insurers in Canada offer bonuses to their career agents, agents or brokers.
- Companies representing more than half of the market share report having loans, ownership and other similar financial relationships with sales intermediaries. Loans and advances can be in different forms, including funds that are owed to the insurer as a result of a draw against commission or a lapse repayment.
- Companies representing the vast majority of the L&H business have policies and procedures in place to mitigate the potential for conflicts of interest.

Possible Policy Options

The IPRC's general policy objective is to reduce the opportunity for actual and potential conflicts of interest in the marketplace while working to promote consumer confidence. This consultation paper outlines a range of possible policy options which the IPRC feels have the potential to balance the business objectives of market participants and the interests of consumers, thus promoting market confidence.

The IPRC suggests that similar standards be applied to both the P&C and L&H insurance sectors, unless there are obvious and compelling reasons to establish separate standards.

This paper does not make specific recommendations but asks for feedback on a number of policy options. The policy options considered in this 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.

(1) Codify the Priority of the Client's Interest:

- Codify a requirement in legislation or regulation that the client's interest be placed above those of the intermediary or third parties.

(2) Restrict Performance-Linked Benefits Offered to Intermediaries:

- Introduce legislation or regulation to restrict insurers from offering performance-linked benefits to their sales intermediaries and similarly to restrict sales intermediaries from accepting performance-linked benefits from insurers. The restriction could be absolute or it could be limited by introducing appropriate controls and qualifications on these benefits (e.g. setting a maximum dollar amount or frequency).

(3) Enhance Transparency of Compensation, Ownership and Other Financial Interests:

- Enhance disclosure of compensation, ownership and other financial interests by legislation or regulation; or
- Work with both the P&C and L&H industry associations to develop best practices for disclosure on a Canada-wide basis.

Scope and Applicability of Policy Options to Intermediaries

The policy options could be applied to:

- (i) only intermediaries who hold themselves out as being independent; or
- (ii) all intermediaries, where possible.

Next Steps

The IPRC invites comments from all interested stakeholders as they pertain to the issues and policy options presented in the consultation paper. The IPRC is also looking for input on whether any action is required and suggestions for additional policy options.

If you would like to provide comments, the IPRC strongly encourages you to review the full consultation paper, which can be found at www.ccir-ccrra.org. The full consultation paper includes questions for stakeholders, and seven appendices: (i) a possible disclosure table; (ii) industry initiatives; (iii) P&C and L&H questionnaire results across Canada; (iv) P&C questionnaire results; (v) L&H questionnaire results; (vi) list of CCIR members; and (vii) list of CISRO members.

After collecting stakeholders' comments and suggestions, the IPRC may recommend that CCIR and CISRO propose to governments the policy options described in this paper, or other options proposed by stakeholders during the consultation. Following the consultation process, individual provincial and territorial insurance regulators will review the stakeholder input with their respective governments to determine what action, if any, is required.

1. Making Your Submissions

**Canadian Council of Insurance Regulators (CCIR)
and
Canadian Insurance Services Regulatory Organizations (CISRO)**

**Industry Practices Review Committee
Relationships between Insurers and Sales Intermediaries
Consultation Paper**

The Industry Practices Review Committee (IPRC) was formed in October of 2004 to ensure a coordinated national approach to regulators' review of insurance practices regarding the relationship between insurers and sales intermediaries. The IPRC welcomes the comments, suggestions and ideas of consumers and insurance industry stakeholders regarding the issues described in this consultation paper.

An electronic copy of this consultation paper is available on CCIR's website at www.ccir-ccra.org. We look forward to receiving your submissions by August 3, 2005. Electronic submissions are preferred. Written submissions and questions should be forwarded to:

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CCIR and CISRO intend to make the submissions received publicly available. If you indicate that 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.

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

2. What is this Consultation Paper About?

This consultation paper seeks to review several aspects of the relationship between insurers and their sales intermediaries (e.g. insurance agents and brokers) in the Canadian insurance marketplace. It summarizes the types of practices used by insurers to remunerate sales intermediaries and some of the ownership and financial linkages between insurers and intermediaries. It also discusses public policy issues following from these practices and possible policy options that could be used to enhance consumer confidence in the insurance market place.

The IPRC is seeking your views about these practices, issues, and options in order to provide advice to provincial and territorial insurance regulators and their governments.

The options in this consultation paper are for discussion and consultation purposes only. After collecting stakeholders' comments and suggestions, the IPRC may recommend that CCIR and CISRO propose to governments the policy options described in this paper, or other options proposed by stakeholders during the consultation. Following the consultation process, individual provincial and territorial insurance regulators will review the stakeholder input with their respective governments to determine what action, if any, is required.

3. Background

CCIR and CISRO

CCIR is an inter-jurisdictional association of insurance regulators. Its mandate is to facilitate and promote an efficient and effective regulatory system in Canada.

CISRO is an organization of licensing and regulatory authorities for insurance intermediaries, including insurance agents and brokers, across Canada.

One of the major goals of both of these organizations is to facilitate harmonization of insurance regulation across Canada to benefit both consumers and the insurance industry.

The policy options discussed in this consultation paper are intended for consideration by all jurisdictions in Canada. Working towards a harmonized approach promotes efficiencies and cost savings while providing consistent protection to consumers across Canada. It is recognized that individual jurisdictions may need to accommodate any local or regional issues in implementation.

Reason for Review

Since late 2004, a number of U.S. regulators and state governments have investigated and taken legal action against a number of insurers, brokerages and

individuals, alleging fraudulent, coercive and dishonest practices in the sale of insurance products. These practices include the alleged rigging of bids for insurance and concerns about the payment of contingent commissions and other sales incentives.

CCIR and CISRO decided to conduct a review of the relationships between insurers and sales intermediaries (such as brokers and agents) to determine if issues similar to those in the U.S. could arise in Canada, and to identify opportunities to enhance public confidence in the Canadian insurance marketplace.

In October 2004, CCIR and CISRO established the IPRC to examine the financial relationships between insurance companies and their sales intermediaries (e.g. contingent commissions, ownership and financial links, and sales incentives) that have the potential for creating conflicts of interest. The main tool for the IPRC review was a detailed market conduct questionnaire for insurers. The questionnaire examined various aspects of the relationship, including the payment of contingent commissions, sales incentives and ownership linkages and focused on the corporate governance issues of insurers, including the existence of policies and the monitoring and approval of policies.

Questionnaires and Information Gathering

A questionnaire for Property and Casualty (P&C) insurance companies was distributed on November 1, 2004, and a separate questionnaire for Life and Health (L&H) insurance companies was distributed on December 2, 2004.

The results of the questionnaire assisted the IPRC in conducting fact-based policy analysis. Accordingly, the IPRC has prepared this paper for discussion and consultation with stakeholders, consumers and the public on a Canada-wide basis.

Concurrent with this exercise, the Registered Insurance Brokers of Ontario (RIBO) developed its own questionnaire that was distributed to Ontario licensed P&C insurance brokers. The RIBO survey requested information on markets, volumes and direct or indirect financial interests in the brokerage by an insurer, including share ownership and/or loans made by insurers. It was intended to complement the IPRC's review and add context to discussions on the practices and financial arrangements between P&C brokers and insurance companies. Concurrent with the release of this consultation paper, RIBO is releasing a report on its survey, which is available on the RIBO website (www.ribo.com).

In Québec, the Autorité des Marchés Financiers (AMF) developed questionnaires for insurance companies and sales intermediaries licensed in Québec. Where compatible, responses from insurers received by the AMF have been included in the IPRC's questionnaire results reports.

On April 14, 2005, the AMF released a report entitled, *Commercial Practices in the*

Québec Damage Insurance (Property & Casualty) Brokerage Sector, which is available on the AMF website (www.lautorite.qc.ca/accueil.en.html). The AMF is expected to undertake a public consultation process on proposed regulatory options. The consultation is scheduled for the beginning of September, 2005. The related documentation will go out to stakeholders in early Summer 2005. The results of the consultation will be compared to those of the CCIR and CISRO at the CCIR Fall meeting in an effort to harmonize policy approaches across jurisdictions in Canada. The AMF also intends to analyze the L&H insurance industry. The AMF has indicated that it will send a complementary questionnaire to intermediaries in the L&H sector.

Findings

General Findings:

The analysis of questionnaire responses revealed that most insurers have written policies and procedures in place governing compensation to brokers, agents, and other sales intermediaries.

The responses to the questionnaires did not provide evidence of any illegal insurance related activity. Regulators continue to monitor the market place and will take any action necessary if illegal activity is alleged or detected.

It should also be noted that while in some respects the insurance marketplace is similar across Canada, regional differences exist. For example, one of the main findings of the AMF report is that a large majority of the Quebec P&C brokerage network is not independent of insurers, and that Quebec P&C brokers concentrate their business with one or two principal insurers. However, the extent of market concentration may vary across jurisdictions in Canada. The RIBO survey supports the conclusion that there does not appear to be any unexpected concentration issues or any “steering” issues among P&C brokerages in Ontario, by reason of a financial linkage or business relationship with an insurer.

The IPRC believes that some current business practices may contribute to a perception of or actual conflicts of interest in the marketplace. At issue is the appearance to a reasonable, informed, third party that bias exists in the course of providing advice to consumers due to a conflict of interest or potential conflict of interest. This may have a negative impact on consumer confidence in the insurance marketplace. To address potential risks to insurance market confidence, the IPRC has prepared a number of policy options for consultation.

Findings Specific to the P&C Insurance Questionnaire:

- The majority of companies use brokers to sell their insurance policies.
- Insurance companies use standard contracts with their brokers that undertake to sell insurance on the company’s behalf.

- More than two-thirds of insurers in Canada offer contingent commissions to their agents or brokers.
- The use of non-monetary sales incentives (e.g. learning retreats, workshops and golf tournaments) appears to be minimal with a few exceptions.
- The majority of insurance companies have policies and procedures in place to mitigate the potential for conflicts of interest.
- More than half of the companies report having loans, ownerships and other similar financial relationships with sales intermediaries.

Findings Specific to the L&H Insurance Questionnaire:

- The majority of companies use career agents, agents (managing general agents, associate general agents and personal producing general agents) and brokers to sell their insurance policies.
- Insurance companies use standard contracts with their career agents, agents and brokers that undertake to sell insurance on the company's behalf.
- All companies in Canada offer bonuses to their career agents, agents or brokers.
- The use of sales incentives, including non-monetary sales incentives paid to agents and brokers (e.g. learning retreats, workshops and golf tournaments) appears to be universal.
- Companies representing more than half of the market share report having loans, ownerships and other similar financial relationships with sales intermediaries. These loans and advances may be in different forms, including funds that are owed to the insurer as a result of a draw against commission or a lapse repayment.
- Companies representing the vast majority of the L&H business have policies and procedures in place to mitigate the potential for conflict of interest.

4. Policy Development Framework

Public Policy Objectives

The policy options discussed in this consultation paper were guided by the following public policy objectives:

- **Market confidence** – promoting the integrity and reputation of the insurance industry and the provision of objective advice.
- **Informed consumers** – providing consumers with a disclosure environment conducive to making well-informed insurance decisions.
- **Level playing field** – ensuring that different types of market participants are not inappropriately advantaged or disadvantaged, relative to others, by the regulatory framework.
- **Responsive insurance regulation** – recognizing that regulatory structures and frameworks need to be aligned with evolving market realities. Regulators need to keep pace with, and have adequate regulatory instruments to respond to, the changing regulatory environment.

- **Harmonization** – encouraging adoption of harmonized regulatory standards as much as practicable across jurisdictions so that consumers enjoy a consistent level of protection regardless of where they live.
- **Competitive markets** – fostering a healthy and efficient insurance industry.

Insurer-Intermediary Relationships and Consumer Protection

Consumers purchase insurance products from insurance companies either directly or through different types of sales intermediaries, such as career agents and independent brokers/agents. These intermediaries often have relationships with insurers, involving compensation and ownership/financial linkages.

Some intermediaries hold themselves out as being independent and consumers may have expectations about the objectivity, role and obligations of these intermediaries in sales transactions. Independence implies that an intermediary:

- accesses insurance coverage from more than one company (or market);
- places insurance policies for their clients with the company that offers the best combination of price, coverage, and service; and
- provides information on insurance companies and products.

A consumer protection concern arises when an intermediary holds himself/herself out as being independent, yet places himself/herself in a conflict of interest, or potential conflict of interest. A conflict of interest occurs when an intermediary has an incentive to act contrary to the best interest of the client or prospective client, and as a result, the intermediary provides advice or a product recommendation which may be inappropriate for that consumer.

It is not always possible or necessary to establish the existence of actual bias in favour of one product or one insurer over another. Since determination of actual bias requires knowledge of the considerations or motivations of an intermediary, it may not always be possible to conclude the advice provided is actually conflicted. Furthermore, if the business practices in the marketplace provide incentives that have the potential to encourage biased advice, consumer confidence may be undermined.

Rationale

The IPRC's objective is to balance the business objectives of market participants and the interests of consumers. The role of an independent intermediary is to act on behalf of clients, determining and assessing the clients' needs and identifying the products that are available and suitable to meet those needs. At the same time, it is also recognized that the intermediary must establish business relationships with insurers in order to sell various products. Insurers use monetary and non-monetary benefits as tools to motivate their sales force.

The policy options address business practices that pose higher risks of creating conflict of interest in the marketplace. As such, the policy options reflect the IPRC's assessment of what might be required to mitigate such risks. For example, restriction might only be contemplated for those practices that pose the highest risks and where the restriction could be effectively enforced.

The policy options also build on various existing regulatory and industry-sponsored consumer protection measures that are currently in place. It should be noted that some jurisdictions currently have consumer protection measures which promote greater transparency through disclosure.

Scope and Applicability

Intermediaries

The IPRC recognizes that consumers purchase insurance products from different types of intermediaries. Accordingly, any policy option which is adopted needs to recognize these differences, taking into consideration statutory requirements across jurisdictions in Canada and common law obligations.

In Canada, intermediaries are regulated at the provincial / territorial level. In accordance with provincial / territorial insurance statutes, each jurisdiction may issue different classes of licences for intermediaries by types of insurance (e.g. P&C, Life, Accident & Sickness) and/or by function (broker and agent). For example, some Canadian jurisdictions issue a separate class of licence for P&C brokers. In addition, each class of licence may impose specific obligations and responsibilities on an intermediary. Furthermore, common law imposes standards and duties on intermediaries, including standards and duties owed to the client. These standards and duties depend on, among other factors and considerations, the intermediaries' relationships with their clients and the nature of the services sought by, or provided to, the client.

There appear to be two approaches for applying the policy options discussed in this paper to intermediaries:

- 1. The policy options could be applied to intermediaries who hold themselves out as being independent.** This consultation paper starts with the view that intermediaries, who hold themselves out as being independent, in both L&H and P&C sectors, are expected to provide objective advice and recommendations to consumers. Accordingly, transactions involving these independent intermediaries should be subject to more comprehensive consumer protection measures, to reduce the possibility of conflicts of interest. Independence may be interpreted or described in a number of ways, including the following:

- All intermediaries could be considered independent unless they hold themselves out as representing only one insurer, in which case this should be clearly disclosed to consumers.
- All intermediaries could be considered to be non-independent unless they can demonstrate their independence from insurers. This would require the development of criteria to define what constitutes independence. The criteria would need to be clear to both intermediaries and consumers, and be easy to administer.
- One may argue that using “number of insurers” as an indicator of independence has limitations. For example, the AMF report indicates that the concentration of business volume by Quebec P&C brokers is fostered by various commercial practices with insurers (e.g. loans, ownership ties, block transfers of business, and contingent commissions). Therefore, in practice, the choices of markets offered to consumers may be more limited than consumers perceive.
- However, the RIBO survey results indicate that although a small number of Ontario P&C brokerages have high volumes with their “business related” insurers, they are almost exclusively “program” brokers that have an arrangement with one insurer to market policies to specific groups (e.g. university alumni), or the brokerage markets to groups through call centre programs.

2. The policy options could be applied to all intermediaries, where possible.

This approach recognizes that consumers would benefit from additional measures intended to manage conflicts of interest or potential conflict of interest in the marketplace, regardless of the type of intermediaries. However, some of the policy options (such as disclosure of ownership or financial relationships) would not be applicable in a direct sales environment.

Insurers

The policy options are applicable to all insurers in both L&H and P&C sectors, with consideration given to the distribution channels employed by these insurers.

5. Possible Policy Options

The policy options considered in this consultation paper are:

1. Codify the priority of the client’s interest;
2. Restrict the performance-linked benefits offered to intermediaries; and
3. Enhance transparency of compensation, ownership and other financial interests.

This consultation paper suggests that one should expect similar standards be applied to both the P&C and L&H insurance sectors, unless there are obvious and compelling reasons to establish separate standards.

1. Codify the priority of the client's interest

An intermediary's duties and obligations towards clients are governed by licensing qualification requirements (e.g. suitability) and through codes of conduct. Conflict of interest rules for intermediaries vary from jurisdiction to jurisdiction in Canada. For example, Québec has a code of ethics that states that a representative must avoid conflicts of interest. In some provinces, intermediaries are required to disclose conflicts of interest or potential conflicts of interest to clients.

Further, a number of industry associations and self-regulatory organizations have introduced codes of ethics, rules, or guidance that may go beyond any conflict of interest requirement contained in provincial insurance legislation. The underlying principle is that intermediaries should always turn their mind to all facts and circumstances, so as to determine whether any conflict of interest exists or would appear to exist, to a reasonable, informed person.

Some industry associations also require their members to avoid conflicts of interest. If a conflict of interest exists or cannot be avoided, the conflict may be addressed through a combination of disclosure and "putting the client first" requirements.

Policy Option

One policy option is to require by legislation or regulation that the client's interests be placed above those of the intermediary or any third party.

This would ensure that where there are conflicts of interest or potential conflicts of interest, the mere disclosure of the conflict would be inadequate if the transaction itself was not in the client's best interests. A rule requiring that the client's interests take priority could potentially result in a better balance between the legitimate commercial interests of intermediaries and the interests of consumers.

While the IPRC is not proposing to itemize all the steps necessary to satisfy this option, regulators could work with industry associations to provide additional guidance to assist intermediaries' compliance, if the requirement were adopted by provincial and territorial governments.

2. Restrict performance-linked benefits offered to intermediaries

In addition to regular commissions, intermediaries may receive monetary and non-monetary benefits that are not tied to the sale of an individual policy. These additional benefits can include contingent commissions, bonuses and non-monetary sales incentives. The payment of such benefits by insurers to intermediaries can

depend on one or a combination of performance-linked criteria such as sales volume, profitability, growth or retention.

- More than two-thirds of P&C insurers in Canada offer contingent commissions to their agents or brokers. For those intermediaries who qualify, the range of contingent commission is up to 3% of gross written premium of the intermediary.
- All L&H insurers offer bonuses to their career agents, agents or brokers. For those intermediaries who qualify, the range of bonuses on selected individual products is up to 200% of first year's commission and 0.05% to 30% of premium for group products.
- Both P&C and L&H insurers provide non-monetary sales incentives to their sales intermediaries. However, this practice appears to be less prevalent in the P&C sector, as less than a quarter of P&C companies report using sales incentive programs. In contrast, most L&H companies report using them. These non-monetary sales incentives can range from providing training, technical, and consulting support for business volume, to local golf tournaments, cruises, or out of town trips that are often tied to achieving certain performance indicators, such as volume or growth targets.

See Appendices 3, 4 and 5 for further information on the above compensation practices.

The rationale for focusing on performance-linked benefits is that benefits that are not performance-linked (e.g. marketing activities offered in the normal course of business) cannot reasonably be expected to influence the advice given or product offered by the sales intermediary, as no incentive giving rise to the potential conflict of interest may exist.

While some independent intermediaries may argue that performance-linked benefits do not influence their advice or recommendations, they may appear, to a reasonable, informed third party, to result in a potential conflict of interest. In other words, a perception may exist that independent intermediaries could steer consumers to, or away from, specific insurers in order to achieve certain performance targets or to qualify for benefits. This may have a negative impact on consumer confidence in the insurance marketplace.

Currently, the use of monetary and non-monetary benefits is addressed in a number of ways. For example, in the insurance sector, disclosure of sales incentives and contingent commissions may derive from a conflict of interest disclosure requirement. In the securities industry, specific types of sales incentives are prohibited, with a few permitted exemptions.

Policy Options

Legislation or regulation could be introduced to restrict insurers from offering performance-linked benefits to their sales intermediaries and similarly to restrict sales intermediaries from accepting performance-linked benefits from insurers. The restriction could be:

- absolute; or
- limited by introducing appropriate controls and qualifications (e.g. setting a maximum dollar amount or frequency) on these benefits.

Further, in determining what constitutes a performance-linked benefit, the relevant rules could be developed, with industry assistance, that are:

- **Principle-based** – Legislation or regulation would not itemize all possible performance-linked benefits that are restricted. Regulators could work with industry associations to develop principle-based guidance on the rules to assist intermediaries and insurers with compliance; or
- **Compliance-based** – Legislation or regulation would list specific performance-linked benefits that are restricted.

3. Enhance transparency of compensation, ownership and other financial interests

Disclosure is one regulatory tool that can be used to address conflicts of interest, or potential conflicts of interest. The fundamental premise underlying disclosure is that a sales intermediary has the responsibility to ensure that his/her client is fully informed of all information that pertains to the intermediary's advice so that the client is in a position to make an informed purchase decision.

This section discusses two options for improving transparency in the marketplace. The first option establishes the elements of a more rigorous regime that could be codified in legislation or regulation. The second option details an industry-led approach that would be implemented by industry associations.

Policy Options

- 1. Legislated Disclosure Requirements** – Appendix 1 provides a summary table outlining elements of disclosure, which the IPRC feels are important and should be conveyed to the consumer at some point during an insurance transaction. Some of these elements can be conveyed by the insurer, some by the intermediary. Some can be made verbally while others should be confirmed in writing. In addition it is felt that the requirements for P&C insurance business may be somewhat different than those for L&H insurance business due to fundamental differences in the nature of the products being sold and their distribution channels.

The requirements detailed in Appendix 1 build on existing initiatives in both the P&C and L&H sectors. In particular, P&C insurers adopted co-operative disclosure measures in Ontario beginning January, 2005. L&H associations have also implemented initiatives on both product and intermediary disclosure (see Appendix 2).

The following highlights the main features of this option:

- ***P&C Intermediary Disclosure Prior to or at Point of Sale*** – Disclosure by P&C intermediaries of certain information arguably needs to take place prior to or at the point of sale (e.g. number of markets, quote information and compensation information). This point of sale disclosure could be verbal, or in writing if requested. Intermediaries would retain evidence of any verbal disclosure, such as a record of the conversation, for compliance purposes.
- ***P&C Intermediary Disclosure after Purchase or Renewal*** – Disclosure of other information can reasonably occur after purchase or renewal (e.g. loans, ownership and other similar financial relationships and ranges of regular commissions). This would be provided in writing, as confirmation or further elaboration of information already provided verbally before or at the point of sale.
 - This disclosure provides consumers with a more complete understanding of all the business relationships an intermediary has with insurers. Disclosure of the range of applicable compensation may encourage more competition in terms of price and quality of services/products and improve market efficiencies in the long term.
 - One of the policy considerations with respect to the imposition of any new disclosure requirements is the potential administrative burden placed on intermediaries. Since the information required to be disclosed under this option may largely be generic in nature (with the exception of the dollar amount), it is expected that the administrative costs of providing such information should not be excessive.
- ***P&C Insurer Disclosure*** – Building on current industry co-operative practices introduced in Ontario in January 2005, mandating existing insurer disclosure helps create a level playing field among insurers and ensures these practices continue. The requirement for P&C insurers to provide the names of brokers representing the insurer gives consumers an additional tool to shop the market.
 - It is contemplated that insurer disclosure would be in writing. It is anticipated that insurers could use their web sites for the disclosure requirements.

- Not all elements of disclosure are equally applicable to all insurers. For example, some insurers may employ agents only and some types of compensation are not applicable to direct writers that only employ agents.
 - **L&H Intermediary Disclosure** – Most of the disclosure elements for L&H intermediaries should be consistent with those of P&C intermediaries, except where business differences warrant different treatment. Channel specific disclosure would need to be considered.
 - As in the P&C sector, a description of the services provided by the agent to the client reduces the risks of the client misunderstanding the intermediary's roles and responsibilities. This is particularly important because of the variety of products and services offered by intermediaries in the L&H sector. Further, many intermediaries are dually licensed in both insurance and securities sectors and can offer other services, such as financial planning.
 - Not all L&H consumers know which class or type of L&H product (e.g., whole life versus universal life) they require or plan to purchase. Therefore, it is suggested that intermediaries be required to disclose the names of all insurers they represent, broken down by class or type of product.
 - This option has considered the disclosure elements in the CLHIA Reference Document on Advisor Disclosure.
 - **Disclosure for Savings or Investment Products** – Savings or investment products such as Individual Variable Insurance Contracts (IVICs, also known as segregated funds) are very different from other L&H products, and are sold more like securities products such as mutual funds. The regulation of IVICs is also different from other L&H products.
 - Although provincial insurance regulators regulate IVICs, all provincial and territorial regulators have accepted the CLHIA Guidelines. This means the requirements for disclosure documents (information folder on IVICs) are applied consistently across Canada. Accordingly, the disclosure requirements for IVICs are detailed separately in Appendix 1.
 - For savings or investment products, quotation information such as the lowest premium quotation, would not be required. Further, some jurisdictions currently require insurers to disclose information about these products in writing at or before the point of sale.
 - **L&H Insurer Disclosure** – The possible disclosure elements for L&H insurers are consistent with the requirements for P&C insurers.
- 2. Industry-Led Best Practices For Disclosure** – Another option is for regulators to work with both P&C and L&H industry associations to develop best practices for disclosure on a Canada-wide basis. This could mean, for example, the expansion of the co-operative measures already implemented by the Insurance Bureau of Canada (IBC) and the Canadian Life and Health Insurance Association

(CLHIA) (See Appendix 2). It should be noted that some intermediary associations have made progress in encouraging more transparency and openness in the marketplace. Regulators may consider consulting with stakeholders on any additional disclosure measures that could be adopted by these associations.

6. Next Steps

After collecting stakeholders' comments and suggestions, the IPRC may recommend that CCIR and CISRO propose to governments the policy options described in this paper, or other options proposed by stakeholders during the consultation. Following the consultation process, individual provincial and territorial insurance regulators will review the stakeholder input with their respective governments to determine what action, if any, is required.

Although the AMF has its own process, it has expressed its desire to implement harmonized solutions.

7. Questions for Stakeholders

The policy options outlined in the paper are for consultation purposes only. The IPRC welcomes the comments, suggestions and ideas of consumers and insurance industry stakeholders regarding the information, issues and options described in this consultation paper. Please use the questions below to help structure your suggestions and comments. The IPRC also welcomes additional questions or comments.

Policy Options

1. How do the policy options affect you (consumer, intermediary or insurer)? Do the policy options alter current intermediary relationships with insurers and consumers/clients respectively, and if so, how?
2. How would the policy options affect the existing methods of insurance distribution?
3. Are the policy options the best means of accomplishing the objectives identified in the consultation paper?
4. Have the policy options overlooked any other approaches or considerations? If so, please provide us with an outline of those approaches or considerations.
5. As a consumer/client do you feel your interests will be better protected by some or all of the policy options? Which policy options do you believe would offer the most value in making your insurance purchasing decisions?
6. Are there any regional issues or considerations such as different distribution channels that have not been adequately considered?

Scope and Applicability

7. This consultation paper proposes two potential approaches for determining the scope and applicability of the policy options. Do you have a suggested approach for determining the scope and applicability of the policy options?
8. Should some or all of the policy options apply only to intermediaries that hold themselves out as independent, or should they apply to all intermediaries?
9. Do you have any suggestions for describing or interpreting independence?
10. Some intermediaries provide additional services to insurers or to consumers on behalf of insurers. Are there any services provided by intermediaries that may

create conflicts of interest or potential conflicts of interest? If so, do you have any suggestions to address such conflicts?

Performance-Linked Benefits Provided by Insurers to Intermediaries

11. Is the concept of performance-linked benefits sufficiently clear?
12. Should performance-linked benefits be regulated, and if so, how?
13. Should the restrictions on performance-linked benefits be absolute or limited by introducing appropriate controls and qualifications (e.g. setting a maximum dollar amount)?
14. In determining what constitutes a performance-linked benefit, should the relevant rules be principle-based or compliance-based?
15. Some insurers offer services or assistance to intermediaries (e.g. office space). While these services or assistance may not be linked to a specific performance target, some may argue that they create a potential conflict of interest. Do you agree that regulatory measures need to be introduced to address this potential conflict of interest?

Disclosure

16. The disclosure option provides for differing levels of detail, timing and methods of disclosure. As an intermediary or insurer, do you anticipate any difficulties in complying with this option? As a consumer/client does this option provide information on intermediary relationships with insurers that is meaningful and useful for an insurance purchase?
17. Is the scope of the disclosure option broad enough to provide consumers/clients with sufficient information to make informed purchase decisions? If not, what else should be included? Do you have any suggestions as to how this disclosure option could be structured so that it would be easier to understand?
18. As an intermediary or insurer, do you anticipate any difficulties disclosing the **quantum** of any commissions and service fees associated with the specific transaction, excluding any contingent commissions, expressed in dollars and as a percentage of the premium?
19. Do consumers need to understand how an intermediary is paid for his/her services (e.g. contingent commissions and bonuses) and how much in financial terms the intermediary earns from the sale of a policy to a consumer? Is it relevant information for the consumer?

20. Are there any innovative methods of satisfying disclosure requirements that you can provide that have not been considered in this consultation paper?

21. Are there any alternatives to disclosure that regulators should consider?

L&H Insurance

22. Should all L&H products be subject to the same requirements or are there situations where exemptions should be permitted?

Regulatory Compliance

23. Are the policy options cost-effective and enforceable?

Appendix 1

Possible Disclosure Requirements

This table summarizes the disclosure elements for intermediaries and insurers in both the P&C and L&H sectors. A brief discussion of the disclosure elements follows the table.

Possible Disclosure Elements	P & C			L&H (Disclosure must be in writing)		
	Intermediaries		Insurer	Intermediaries		Insurer
	Verbal (At or prior to point-of-sale)	Written (After purchase)		All products	Investment type products	
1. Number of Markets						
Names of all the intermediaries with whom the insurer has a distribution contract (i.e., independent intermediaries who deal with the general public), broken down by class of insurance.			✓			✓
Number of insurers represented by the intermediary for the class or category of insurance sought by the client.	✓					
Names of all insurers represented by the intermediary for the class or category of insurance sought by the client.		✓				
Names of all insurers represented by the intermediary broken down by class of insurance or types of products.				✓	✓	
2. Product Information						
Coverage details of the recommended product.				✓	✓	
Insurance company offering recommended product.	✓			✓	✓	
3. Quotation Information/Illustrations						
Number of quotations/illustrations obtained by the intermediary.	✓			✓		
Lowest quotation/illustration obtained.	✓			✓		
If there are any financial or ownership interests between the intermediary and the recommended insurer, all of the quotations/illustrations obtained by the intermediary.	✓			✓		
Indication if the recommended product is the lowest	✓			✓		

Appendix 1

Possible Disclosure Elements	P & C			L&H (Disclosure must be in writing)		
	Intermediaries		Insurer	Intermediaries		Insurer
	Verbal (At or prior to point-of-sale)	Written (After purchase)		All products	Investment type products	
quotation/illustration.						
Reason/rationale for the quote/illustration recommended to the client	✓			✓	✓	
4. Compensation information						
<p>All applicable elements of monetary compensation <u>paid by insurers to intermediaries</u>, i.e., both agents and brokers, including:</p> <ul style="list-style-type: none"> • whether salary is paid; • whether a commission is paid and, if so, the range of commissions paid, broken down by class of insurance; • whether a contingent commission or any other form of commission (e.g. bonus) is paid and, if so, a description of the conditions for qualifying for the commission; • the range, or an estimate of the range, of any contingent or other form of commission (e.g. bonus), if any is paid, as a percentage of the gross written premium or of first year's commission, broken down by class of insurance; and • whether any other remuneration is paid and, if so, what the remuneration is for and an estimate of the range or amount of such remuneration. 			✓			✓
<p>All applicable elements of monetary <u>compensation received by the intermediary</u> in connection with the transaction, including, without limitation:</p> <ul style="list-style-type: none"> • whether salary is received; • whether a commission is received; • whether a contingent or any other form of commission (e.g. bonus) is received; • whether any service fees are received from insurers and, if so, for what services; and 	✓	✓		✓	✓	

Appendix 1

Possible Disclosure Elements	P & C			L&H (Disclosure must be in writing)		
	Intermediaries		Insurer	Intermediaries		Insurer
	Verbal (At or prior to point-of-sale)	Written (After purchase)		All products	Investment type products	
• whether any other remuneration is received and, if so, for what services.						
Range of the commissions paid by each of the insurers represented by the intermediary for the class or category of insurance <u>sought by the client</u> , as a percentage of the premium.		✓				
Range of the commissions paid by each of the insurers represented by the intermediary, as a percentage of the premium, <u>both first year and subsequent years (if it is different)</u> .				✓	✓	
Range, or an estimate of the range, and conditions for qualifications, of any contingent or other form of commission (e.g. bonus), if any is paid, by each of the insurers represented by the intermediary for the class of insurance <u>sought by the client</u> , as a percentage of the gross written premium or of first year's commission.		✓				
Range, or an estimate of the range, and conditions for qualifications, of any contingent or other form of commission (e.g. bonus), if any is paid, by each of the insurers represented by the intermediary, as a percentage of the gross written premium or of first year's commission.				✓	✓	
For policy renewal, indication if the current policy is the lowest quotation.		✓				
Quantum of any commissions and service fees associated with the specific transaction, but excluding any contingent commissions, expressed in dollars and/or as a percentage of the premium.	✓	✓		✓	✓	
5. Services provided						
Description of the services provided by the intermediary to the client.		✓		✓	✓	
6. Ownership / Financial Information						
Whether any financial arrangement exists between the intermediary and the recommended insurer, directly or indirectly, such as a loan,	✓	✓		✓	✓	

Appendix 1

Possible Disclosure Elements	P & C			L&H (Disclosure must be in writing)		
	Intermediaries		Insurer	Intermediaries		Insurer
	Verbal (At or prior to point-of-sale)	Written (After purchase)		All products	Investment type products	
credit facility or other financial interest.						
Whether any ownership interest exists between the intermediary and the recommended insurer, directly or indirectly, such as a share ownership interest by the insurer in the intermediary, share ownership by the intermediary in the insurer, or common ownership of the intermediary and the insurer, for example by a holding company, financial conglomerate or group of companies.	✓	✓		✓	✓	
Whether any ownership interest exists between the insurer and any intermediary, directly or indirectly and, if so, information relating to the interest.			✓			✓
Whether any financial arrangement exists between the insurer and any intermediary, directly or indirectly and, if so, information relating to the arrangement.			✓			✓

Appendix 2

Select Industry Initiatives

P&C – applicable to Ontario

On November 12, 2004, the Insurance Bureau of Canada (IBC) and the Insurance Brokers Association of Ontario (IBAO), announced the following measures would be implemented voluntarily on or before January 1, 2005:

- A new code of Consumer Rights and Responsibilities will be posted on companies' websites and will be sent out with new insurance policies and renewal offers for all lines of P&C insurance.
- Insurers have also committed to disclose additional information on their company websites.
- A new point of sale disclosure protocol has been designed. Brokers will provide consumers with a document containing information described in the protocol. The Protocol will include a list of the insurance companies represented by a given brokerage and the range of commissions provided by these insurers. It will also indicate those companies with which the brokerage has a contingent commission contract.

L&H

On December 21, 2004, the Canadian Life and Health Insurance Association (CLHIA) announced a package of initiatives. The package includes five initiatives:

1. Increased Consumer Awareness: Company websites will make accessible the Consumer Assistance Centre, the industry's consumer publications and a Consumer Code of Ethics, to which all member companies are committed.
2. Product Disclosure: Consumers considering life and health insurance products will receive a product profile conforming to new standards and covering key features relevant to making informed and confident decisions.
3. Compensation Review: Life and health insurers will regularly review and assess their sales-related compensation practices and structures including from the perspective of their customers' interests.
4. Travel Incentives: Companies offering such incentives will make disclosure by the intermediary a condition of eligibility.
5. Intermediary Disclosure: Companies will work cooperatively with intermediaries distributing life and health insurance products so that customers receive a brief, clear intermediary disclosure document.

The product disclosure initiative was completed and implemented in Spring 2005.

With respect to intermediary disclosure, the CLHIA has worked with Advocis, the Independent Financial Brokers of Canada, and the Canadian Association of Independent Life Brokerage Agencies to develop a Reference Document on Advisor Disclosure (March 2005), which provides guidance and sample disclosure text for intermediaries. The advisor disclosure document includes:

- Information about insurers that the advisor represents
- Information about the nature of those insurer/advisor relationships
- Information about how the advisor is compensated
- Information about eligibility for additional compensation, either monetary or non-monetary, including travel incentives
- Information about any conflict of interest
- The fact that consumers have the right to ask for additional information.

Appendix 3

P&C and L&H Questionnaire Results Across Canada

The results from the market conduct questionnaire show the business practices in the P&C and L&H industries vary in a number of significant ways. **As these two industries provide very different products, great care should be taken in making any comparisons.** Some of the differences are highlighted below:

- There are more P&C insurers operating in Canada than L&H insurers.
- Some of the P&C compensation practices are as follows:
 - P&C products are typically six or twelve month contracts.
 - For P&C products, intermediaries are usually paid level commissions. For example, a private passenger auto policy's first year's commission would be 12.5% of premium, with the same amount being paid in each year following.
 - The typical annual commission paid by P&C insurers for private passenger auto, commercial auto, homeowner, and commercial property are 12.5%, 12.5%, 20%, and 25%, respectively.
 - More than two-thirds of P&C insurers in Canada offer contingent commissions to their agents or brokers. For those intermediaries who qualify, the range of contingent commissions is up to 3% of gross written premium of the intermediary.
- Some of the L&H compensation practices are as follows:
 - Individual L&H products (which account for 38% of industry total revenue, including health benefits) are multi-year contracts.
 - For those L&H products, intermediaries usually receive a higher commission in the first year and a lower commission in subsequent years. For example, a Universal Life's first year's commission may be 60% of premium, with 3% of premium paid in each of the following years.
 - The typical first year's commission paid by L&H insurers for individual whole life, universal life, term life, and money products are 60%, 60%, 50%, and 2.5%, respectively.
 - All L&H insurers offer bonuses to their career agents, agents or brokers. For those intermediaries who qualify, the range of bonuses on selected products is up to 200% of first year's commission.
 - Group L&H products (which account for 62% of industry total revenue, including health benefits) are one-year contracts and typical annual commission rates are 1% to 15% of premium.
 - For those who qualify, the range of bonuses on group products is an additional 0.05% to 30% of premium.
- The use of non-monetary sales incentives is more common in the L&H industry than in the P&C industry.

Appendix 3

- The incidence of insurer loans to intermediaries is higher in the P&C industry than in the L&H industry.

Appendix 4

**SUMMARY REPORT
PROPERTY AND CASUALTY QUESTIONNAIRE**

This report provides a summary of the facts arising from insurers' responses to the property and casualty questionnaire. It neither interprets nor evaluates the information. Officers of the companies were required to attest to the truthfulness of the responses and have provided corroborating documentary evidence.

Over 200 property and casualty insurance companies conducting business in one or more of Canada's 13 jurisdictions (10 provinces and 3 territories) were required to complete the questionnaire. 74 of the companies conduct business in all 13 jurisdictions. Approximately 74% of direct written premiums are underwritten by 54 of the largest companies.

The following chart lists the number of surveyed companies operating by jurisdiction.

Number of Companies Conducting Business in Each Jurisdiction	
Jurisdiction	# Companies
Alberta	121
British Columbia	108
Manitoba	113
New Brunswick	114
Newfoundland & Labrador	113
Nova Scotia	107
Ontario	173
Prince Edward Island	112
Quebec	142
Saskatchewan	116
Northwest Territories	86
Nunavut	83
Yukon	85

REPORT FINDINGS

How Insurance is Sold in Canada

Consumers have the ability to purchase insurance from companies through a variety of methods, including **direct writers, agents** and **brokers**. **Direct writers** are companies that sell insurance to the public directly. These companies employ individuals to sell

policies by telephone, direct mail or through the Internet. As employees, their compensation is primarily in the form of a salary.

Agents are individuals who are authorized to sell insurance on behalf of a company. Most often they only represent one company. Unlike agents and sales representatives of direct writer insurers, a **broker** is authorized to sell insurance on behalf of a number of companies.

Based on the results of the questionnaire, 154 companies (73%) use brokers to sell some or all of their insurance products.

Contracts

Agents and brokers have contracts with insurance companies for whom they undertake to sell new business and renew and service existing policyholders. The contracts specify the terms and conditions under which a broker or agent is authorized to assume business on behalf of the company. The terms and conditions of a contract typically include:

- the volume or mix of business that the intermediary must place with the company in order for the contract to continue,
- the services that the intermediary will provide on behalf of the company (e.g. underwriting, claims processing, risk management),
- the requirement for intermediaries to actively review the policies sold to ensure they are within the company's underwriting guidelines, and
- the compensation arrangements for these services.

The results of the questionnaire show that companies use standard contracts for their brokers and agents. Over half of the insurers require their brokers and agents to perform other services (e.g. underwriting, claims processing, risk management).

Compensation Arrangements

Agents and brokers do not receive salaries from insurance companies but rather are compensated through commissions paid by the company. There are basically two forms of compensation sales intermediaries may receive for selling insurance policies on behalf of an insurance company: **regular commission** and **contingent commission**.

A **regular commission** is a commission paid as a percentage of the total premium of an insured person's policy. The percentage may vary depending on the type of insurance. For example, the rate of commission paid on auto insurance policies is typically lower than the rate paid on other types of policies such as property and commercial liability.

Based on the responses to the questionnaire, the majority of companies use a standard scale for regular commissions. The range of commissions for Private Passenger Auto contracts is 10% to 12.5%, with a typical 12.5% being paid. Commercial Auto pays a range of 7.5% to 15%, with a typical 12.5% being paid. Homeowner's contracts pay a range of 15% to 25%, with a typical 20% being paid. Commercial Property pays a range of 20% to 25%, with a typical 25% being paid.

A **contingent commission** is additional compensation that an insurance company provides to brokers and agents. The commission is dependent on the financial contributions of the business generated by the broker or agent's business - usually over a three-year period. Unlike a regular commission, contingent commission is not tied to an individual policy. The payment of such a commission can be dependent on one factor or a combination of factors such as sales volume, profitability, growth or retention.

Based on the results of the questionnaire, more than two-thirds of insurers in Canada offer contingent commissions to their agents or brokers. The range of commission is up to 3% and the payment of the commission is based on a combination of the factors noted above. The most common combination, accounting for about one third of all contingent commission arrangements, is volume and profitability.

Beyond these compensation arrangements, less than a quarter of companies report using **sales incentive** programs. Of those that offer sales incentive programs, many offer incentives such as learning retreats, workshops and local golf tournaments. Incentives such as cruises are rare.

When the questionnaire was conducted, only a small percentage of companies reported disclosing information regarding compensation. In the fall of 2004, property and casualty companies belonging to the Insurance Bureau of Canada announced their intention to, as of January 1, 2005, voluntarily disclose information about their compensation arrangements with sales intermediaries as well as information on the kinds of financing and ownership links they may have with sales intermediaries.

Financing and Ownership Links

Based on the responses to our questionnaire, many companies report having a stake in the firms or holding companies of sales intermediaries through ownership of common or preferred shares. These arrangements are typically found in companies belonging to large insurance conglomerates.

More than half of the insurers provide loans to sales intermediaries. These loans can take one of two forms:

- the funds are provided directly by the insurer at market value interest rates; or
- the funds are advanced by a bank and the insurer acts as a guarantor for the loan.

Most companies reported that the loans they provide are primarily to help sales intermediary firms expand their business. Occasionally these arrangements are dependent on a broker meeting a specific volume requirement.

A few companies report that the provision of loans may place sales intermediaries in a position of economic dependence on the insurer. However, in the majority of these cases the sales intermediaries were found to be career agents of the company, only authorized to sell the policies of that company, and therefore already in a position of economic dependence on the insurer.

What Are the Controls Companies Have in Place to Avoid Conflicts of Interest?

Just over three quarters of companies have written policies and procedures in place governing compensation to brokers, agents, and other sales intermediaries. In most cases these policies are approved by senior management and occasionally by a company's board of directors.

Virtually all companies have policies and procedures in place to ensure that quotations generated by brokers are consistent with the companies' underwriting and rating standards. Those that do not are typically companies that offer niche insurance products where the risks are unique and do not lend themselves to standardized formats or rating standards.

In addition, practically all companies have a code of ethics to mitigate the risk that employees of the firm would enter into separate and improper arrangements with sales intermediaries. The majority of companies state that they assign senior officers or designated compliance officers to monitor adherence to the code of ethics. Additionally most indicate that reports of findings are provided to senior management, including boards of directors.

Summary

Based on our review of the questionnaire responses, our key findings include:

- the majority of companies use brokers to sell their insurance policies,
- insurers use standard contracts with the brokers that undertake to sell insurance on the company's behalf,
- more than half of the companies report having loans and other financial relationships with sales intermediaries,
- the use of sales incentives appear to be minimal with a few exceptions, and
- the majority of insurers have policies and procedures in place to mitigate the potential for conflict of interest.

To a reasonably informed individual, some aspects of the financial relationship between insurance companies and sales intermediaries may give the appearance of bias. Consequently, a consumer who only becomes aware of these relationships after an

Appendix 4

insurance policy has been purchased, may question the sales intermediary's motive for placing the policy with a specific company.

Appendix 5

**SUMMARY REPORT
LIFE AND HEALTH QUESTIONNAIRE**

This report provides a summary of the facts arising from insurers' responses to the life and health questionnaire. It neither interprets nor evaluates the information. Officers of the companies were required to attest to the truthfulness of the responses and have provided corroborating documentary evidence.

132 life and health insurance companies, conducting business in one or more of Canada's 13 jurisdictions were required to complete the questionnaire. 45 of the companies conduct business in all 13 jurisdictions. Approximately 90% of direct written premiums are underwritten by 18 of the largest companies.

The following chart lists the number of surveyed companies operating by jurisdiction.

Number of Companies Conducting Business in Each Jurisdiction	
Jurisdiction	# Companies
Alberta	76
British Columbia	70
Manitoba	74
New Brunswick	68
Newfoundland & Labrador	62
Nova Scotia	69
Ontario	79
Prince Edward Island	64
Quebec	73
Saskatchewan	73
Northwest Territories	50
Nunavut	46
Yukon	49

REPORT FINDINGS

How Insurance is Sold in Canada

Consumers have the ability to purchase life insurance products from companies through a variety of channels, including:

Direct writers, which are companies that sell insurance to the public directly. These companies employ individuals to sell policies by telephone, direct mail or through the Internet. As employees, their compensation is primarily in the form of a salary.

Career agents, who are individuals who are authorized to sell insurance on behalf of a company. Most often they represent only one company.

Agents and brokers, who are authorized to sell insurance on behalf of a number of companies.

Based on the results of the questionnaire, the majority of companies use career agents, agents and brokers to sell some or all of their life insurance products.

(*Note: Agents include managing general agents, associate general agents and personal producing general agents).

Contracts

Career agents, agents and brokers have contracts with insurance companies to sell insurance products and provide service to existing policyholders. The contracts specify the terms and conditions under which they are authorized to solicit and assume business on behalf of the company. The terms and conditions of a contract typically include:

- the volume or mix of business that the intermediary must place with the company in order for the contract to continue
- the services that the intermediary will provide on behalf of the company (e.g. underwriting, claims processing, risk management)
- the requirement to actively review the policies intermediaries sell to ensure they are within the company's underwriting guidelines
- the compensation arrangements for these services

The results of the questionnaire show that companies use standard contracts for their career agents, agents and brokers. Companies underwriting three quarters of direct written premiums require their sales intermediaries to perform other services (e.g. initial claims reports, primarily with group, affinity and national accounts).

Compensation Arrangements

Career agents, agents and brokers do not receive salaries from insurance companies but rather are compensated through commissions paid by the company. There are basically two forms of compensation sales intermediaries may receive for selling insurance policies on behalf of an insurance company: **regular commission** and **bonus**.

A **regular commission** is a commission paid as a percentage of the total premium of an insured person's policy. The percentage may vary depending on the type of insurance. For example, as term insurance does not have a savings component, the rate of commission paid on these policies is typically lower than the rate paid on other types of life insurance policies such as whole life or universal life.

Based on the responses to the questionnaire, there are two main approaches to compensation for the sale of individual L&H insurance products. Most companies use a graduated commission approach under which a higher commission is paid in the first policy year, and a lower commission is paid in subsequent years. For example, first year's commission for a Universal Life policy may be 60% of premium, with 3% of premium paid in each of the following years. Some other companies pay a level commission for both first and subsequent years. For example, first year's commission for a Universal Life policy may be 8% of premium, with the same amount being paid in each of the following years.

Individual Whole Life contracts pay commissions in the range of 5% to 8% on a level commission basis. On a graduated commission basis, first year's commission for individual whole life ranges from 40% to 70% with a typical 60% being paid.

Individual Universal Life contracts pay commissions in the range of 8% to 10% on a level commission basis. On a graduated commission basis, first year's commission for individual universal life contracts is 45% to 140%, with a typical 60% being paid.

Individual Term Life contracts pay commissions in the range of 4% to 6% on a level commission basis. On a graduated commission basis, first year's commission for Term Life contracts is 25% to 120%, with a typical 50% being paid.

Money Products (such as IVICs or segregated funds) pay first year's commission in the range of 0% to 5%, with a typical 2.5% being paid.

The range of commissions paid by insurers varies significantly from one insurer to another as well as between types of insurance. Insurers also offer incentives to intermediaries based upon the volume of business and the number of policies renewed.

Group L&H products are one-year contracts and typical annual commission rates are 1% to 15% of premium.

A **bonus** is additional compensation that an insurance company provides to career agents, agents and brokers. Unlike regular commissions, bonuses are not tied to an individual policy. The bonus payments may be dependent on one factor or a combination of factors such as sales volume, growth or retention.

Based on the results of the questionnaire, all insurers in Canada offer bonuses to their career agents, agents or brokers. For those who qualify, the range of bonuses on selected individual products is up to 200% (of first year's commission) and the bonus

payments are based on a combination of the factors noted above. The most used combination is volume and retention. The range of bonuses on group products is an additional 0.05% to 30% of premium.

Beyond these compensation arrangements, 95% of companies report using **sales incentive** programs. Of those that offer sales incentive programs, many offer incentives such as learning retreats, workshops and local golf tournaments. Incentives such as cruises are also commonly offered, with up to 3% of intermediaries qualifying for these trips.

When the questionnaire was conducted, eleven companies underwriting 48% of individual written premiums reported disclosing information to clients regarding compensation; but most of these disclosures were made only when requested. Since the questionnaire was conducted, the L&H industry associations have adopted a new intermediary disclosure protocol, as outlined in appendix 2.

Financing and Ownership Links

Based on the responses to our questionnaire, many companies report having at least a nominal stake in the firms or holding companies of sales intermediaries through ownership of common or preferred shares. These arrangements are typically found in companies belonging to large insurance conglomerates.

15 insurers (representing 59% of the market share) provide advances and loans to intermediaries. These take two different forms:

- the funds are owed to the insurer as a result of a draw against commission or a lapse repayment, and
- the funds are provided directly by the insurer at current market rates, or are advanced by a bank and the insurer act as a guarantor for the loan.

Most companies reported that the loans outlined in the second category are provided primarily to help sales intermediaries expand their business. Occasionally these arrangements are dependent on a broker meeting a specific volume requirement.

A few companies report that the provision of loans may place sales intermediaries in a position of economic dependence on an insurer. However, in the majority of these cases the sales intermediaries were found to be career agents of the company, only authorized to sell the policies of that company, and therefore already in a position of economic dependence on the insurer.

What Are the Controls Companies Have in Place to Avoid Conflicts of Interest?

Almost half of all companies (underwriting 94% of direct written premiums) have written policies and procedures in place governing compensation to brokers, agents, and other sales intermediaries. In most cases these policies are approved by senior management and occasionally, by a company's board of directors.

Almost half of all companies (underwriting 96% of direct written premiums) have policies in place to ensure that quotations generated by brokers are consistent with the companies' underwriting and rating standards. Those that do not are typically smaller companies.

In addition, about half of all companies (underwriting 95% of direct written premiums) have a code of ethics to mitigate the risk of employees entering into separate and improper arrangements with sales intermediaries, with all of those companies monitoring to ensure adherence.

Summary

Based on our review of the questionnaire responses, our key findings include:

- the majority of companies use career agents, agents and brokers to sell their insurance policies;
- insurers use standard contracts with the career agents, agents and brokers that undertake to sell insurance on the company's behalf;
- companies representing more than half of the market share report having loans and other financial relationships with sales intermediaries;
- the use of sales incentives appear to be universal; and
- insurers representing the vast majority of the L&H business have policies and procedures in place to mitigate the potential for conflict of interest.

To a reasonably informed individual, some aspects of the financial relationship between insurance companies and sales intermediaries may give the appearance of bias. Consequently, a consumer who only becomes aware of these relationships after an insurance policy has been purchased, may question the sales intermediary's motive for placing the policy with a specific company.

Appendix 6

List of CCIR Members

Regular Members	
<p>ALBERTA</p> <p>Arthur Hagan Deputy Superintendent, Insurance and Financial Institutions, Alberta Finance</p>	<p><u>Contact Information</u></p> <p>402 Terrace Building 9515-107 Street Edmonton AB T5K 2C3 Tel: 780-422-1592 Fax: 780-420-0752 Arthur.Hagan@gov.ab.ca</p>
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<p>NEWFOUNDLAND AND LABRADOR</p> <p>Winston Morris Superintendent of Insurance Department of Government Services</p>	<p><u>Contact Information</u></p> <p>Confederation Bldg., 2nd Floor, West Block P.O. Box 8700 St. John's NF A1B 4J6 Tel: 709-729-2571 Fax: 709-729-4151 wmorris@mail.gov.nl.ca</p>
<p>NORTHWEST TERRITORIES AND NUNAVUT</p> <p>Douglas Doak Superintendent of Insurance Division of Taxation & Assessment Dept. of Finance, G.N.W.T.</p>	<p><u>Contact Information</u></p> <p>3rd Floor, YK Centre Building 4822-48th Street Yellowknife NT X1A 3S3 Tel: 867-873-7308 Fax: 867-873-0325 doug_doak@gov.nt.ca</p>
<p>ONTARIO</p> <p>Bryan P. Davies Chief Executive Officer & Superintendent of Financial Services Financial Services Commission of Ontario</p>	<p><u>Contact Information</u></p> <p>5160 Yonge Street, 17th Floor PO Box 85 North York ON M2N 6L9 Tel: 416-250-7250 Toll-Free: 1-800-668-0128 Fax: 416-590-7070 contactcentre@fSCO.gov.on.ca</p>
<p>PRINCE EDWARD ISLAND</p> <p>Robert Bradley Superintendent of Insurance Office of the Attorney General</p>	<p><u>Contact Information</u></p> <p>P.O. Box 2000 105 Rochford Street Charlottetown PEI C1A 7N8 Tel: 902-368-4564 Fax: 902-368-5283 rabadley@gov.pe.ca</p>
<p>QUÉBEC</p> <p>Nancy Chamberland, Notary Executive Director Distribution Regulation Directorate Autorité des marchés financiers</p>	<p><u>Contact Information</u></p> <p>2640, boulevard Laurier 4e étage Ste-Foy (Québec) G1V 5C1 Tel: 418-525-0558 Fax: 418-528-7011 resegnements-industrie@lautorite.qc.ca</p>

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<p>Associate Member</p>	
<p>FEDERAL GOVERNMENT</p> <p>Patty Evanoff Senior Director Legislation & Approvals Division Office of the Superintendent of Financial Institutions Canada</p>	<p><u>Contact Information</u></p> <p>15th Floor, Kent Square, 255 Albert Street Ottawa ON K1A 0H2 Tel: 613-990-9004 Fax: 613-998-6716 Patty.Evanoff@osfi-bsif.gc.ca</p>

Appendix 7

List of CISRO Members

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<p>BRITISH COLUMBIA Insurance Council of British Columbia</p> <p>Agnes Healey Deputy Executive Director</p>	<p><u>Contact Information</u></p> <p>Insurance Council of BC 300-1040 West Georgina Street P.O. Box 7 Vancouver BC V6E 4H1 Tel: (604) 688-0321 Fax: (604) 662-3726 Ahealey@insurance-council.bc.ca</p>

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