

***The Canadian Council of Insurance Regulators***  
***and***  
***The Canadian Insurance Services Regulatory Organizations***

***Incidental Selling of Insurance Working Group***

**INCIDENTAL SELLING OF INSURANCE**

**CONSULTATION DOCUMENT**

**Winter 2008**

Ce document est également disponible en français

## **Background - CCIR and CISRO**

The Canadian Council of Insurance Regulators (CCIR) is an inter-jurisdictional association of provincial, territorial and federal insurance regulators. The provincial and territorial regulators are responsible for market conduct regulation and legislative compliance of insurers authorized in their province or territory. They may also have responsibility for the solvency of insurers incorporated in their jurisdictions.

The Canadian Insurance Services Regulatory Organisations (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. 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.

## Part 1 - Consultation Document

### **Background**

The Incidental Selling of Insurance (“ISI”) distribution channel has grown over the years and has been subject to different levels of regulatory oversight from jurisdiction to jurisdiction. In spring 2007, the CCIR decided to examine ISI licensing and consumer issues because of their potential ongoing impacts. The Incidental Selling of Insurance Working Group (“ISI WG”), which includes representatives from CCIR and from CISRO, was formed to conduct this examination.

To date, through the work of the ISI WG, regulators have discussed perceived issues and shared their concerns pertaining to ISI. At this point, our goal is to share our current thinking and gather information from stakeholders to support our understanding of ISI. This consultation document is intended to stimulate a constructive discussion with industry and consumer associations. We hope that industry participants and consumers will advise the committee of any experiences they have had with ISI products or regulation that have created problems for them and that they will share their thoughts with us on the questions we pose in Part 2 of this paper.

In evaluating ISI, the ISI WG intends to follow a risk-based approach. As such, we will bear in mind the regulatory outcomes listed in CCIR’s recently released paper, *An Approach to Risk-based Market Conduct Regulation*. This paper is available on the CCIR’s web site at <http://www.ccir-ccra.org>

### **Definition of Incidental Selling of Insurance (“ISI”)**

Most jurisdictions do not have a legal definition of ISI. The ISI WG agreed on a common definition in order to pursue the discussion. The proposed definition is inspired by section 408 of an *Act Respecting the Distribution of Financial Products and Services* (Quebec)<sup>1</sup>:

“An incidental seller of insurance is a person who, in pursuing activities in a field other than insurance, offers, as an accessory, for an insurer, an insurance product which relates solely to goods sold or services offered by the person or secures a client’s enrolment in respect of such an insurance product.”

The definition above does not include the situation of an employer “enrolling” an employee in a group life policy, as it is not considered to be an offer. It relates, but is not limited to, insurance sold by automobile dealers, by travel agents and agencies, by mortgage brokers, by retailers and through branches of lending institutions such as banks, credit unions, finance companies and pay-day lenders. These insurance products may pay off the balance of, or make payments on, a loan, a credit card or a credit line in case of disability or death. They may also be out-of-Canada health insurance or even prepaid funeral expenses. The common factor is the method of sale used.

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<sup>1</sup> R.S.Q., chapter D-9.2

## **The Incidental Selling of Insurance Industry at a Glance**

In trying to quantify ISI, the closest we could come to ISI statistics were figures on alternate distribution channels. According to these figures, the total premium generated through alternate distribution channels for 2006 amounted to almost \$4.8 billion.<sup>2</sup> This number represents only that business conducted by 32 CLHIA member companies. Although the CLHIA definition of the alternate distribution market – that it involves the distribution of insurance products without the traditional face-to-face contact between the consumer and agent – includes some business not in our definition of ISI, this number still provides a good approximation of the industry size.

To our knowledge, ISI data in the Property & Casualty (“P&C”) sector are not available but we understand such products exist.

### **Introduction**

In assessing the appropriateness of an ISI sales process, the fundamental question is:

**Is the consumer in a position at the time of sale to make an informed decision about his purchase?**

The rest of Part 1 of this paper discusses perceived ISI issues which we believe have the greatest potential impacts on informed consumer decision-making, and those affecting regulatory oversight of this distribution channel.

### **Suitability & Documentation**

#### **Suitability**

An unsuitable product can lead to consumers paying for insurance they do not need, to expectation gaps at the time of a claim, or to consumers paying for coverage for which they would never have been eligible to make a claim. Many ISI sellers are perceived as having no obvious incentive to ensure product suitability to the specific consumer, though the consumer may not realize this.

The ISI WG notes that the relationship between the sellers and the consumers of ISI products ranges from a very neutral relationship where sellers merely make a product available, to, at the other extreme, a relationship where advice is sought and given. Both situations raise questions about suitability and informed consumer decision-making.

When the seller merely makes a product available, the consumer is left to self-assess the suitability of the offered product. In some cases, the consumer can only undertake this self-assessment after the sale is completed and the insurance certificate is delivered. This is particularly true with group insurance policies. We would have to conclude that in these cases

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<sup>2</sup> Canadian Life and Health Insurance Association Inc. (CLHIA), Alternate Distribution Market in Canada – 2006 (December 2007).

the consumer may not be in a position at the time of sale to make an informed decision about his purchase.

This situation might be improved if insurers make certain that adequate and appropriate information to allow consumers to self-assess suitability is presented at the time of the sale.

Additionally, if the responsibility for determining suitability is solely that of the consumer, it is necessary to consider whether the sales environment is conducive to the consumer making such decisions. Since the sale of ISI products is incidental to the purchase of another product or service, one can conclude that a consumer is not focussed on his insurance needs at the time of the purchase.

While sellers may not expect that they are giving advice, even in the most neutral sales environment, it can be expected that sellers will respond to consumers' questions. Answering these questions may move the seller closer to an advisory role. When ISI sellers are answering questions that pertain to the suitability of the product to a particular consumer, the consumer has a right to expect that he will be receiving full and accurate information and unbiased advice that is in his best interest. In these cases, we would expect that the responsibility for validating that the product is suitable for the consumer would move to the seller. This would imply some kind of personal and financial situation analysis that is not currently the norm in ISI sales.

## **Group Insurance Issues**

When ISI products are offered through group insurance, consumers may have great difficulty determining the suitability of the coverage. Important details about exclusions, restrictions and limitations may be disclosed on the master policy. Consumers often have no easy access to the master policy but rely only on the insurance certificate as source of information. Consumers, should they want to review the extent of the coverage, must proactively request the wording of the policy. This situation does not encourage them to read the policy and understand their coverage. Also, the insurance certificates the consumer receives sometimes summarize the conditions of the master policy, leaving room for misinterpretation.

## **Application Forms and Policy Wording**

Application forms used in ISI often ask few to no qualification questions of the consumer. Eligibility criteria are included in the policy and formulated as exclusions, restrictions and limitations ("ERL"). This results in some tasks that are normally part of the insurer's underwriting process being transferred to the consumers. That is, consumers are left to self-assess their eligibility for coverage based on the wording of the certificate or policy. Including a restriction of coverage for pre-existing conditions in the policy is a good example of a practice that forces consumers to assess whether the coverage will meet their needs.

Including ERL in the policy wording raises many potential issues. First, consumers may not read their policy but, instead, base their understanding of the coverage on the explanations they receive during the sales process. In addition, many consumers may not have the knowledge and ability to understand the scope of application of complex ERLs, which may result in expectation gaps when a claim is made.

The approaches used in the wording of the ERLs also raise potential issues. Some insurers use an exhaustive wording while others adopt a general wording. Both approaches have their advantages and disadvantages. For example, an exhaustive enumeration of each medical and

non-medical condition influencing the coverage may be lengthy, which can make it difficult for the consumer to understand the policy and make it less likely that he will read the policy. On the other hand, a general description, though easier to read, leaves room for different interpretations and will inevitably cause contentious situations when claims are declined.

### **Proper Disclosure of ERLs in Plain Language**

The ISI WG notes that the ERL defined in insurance contracts can sometimes be beyond the comprehension of the average consumer. The consumer, acting in good faith, may not understand the relevance to his ultimate insurability of some piece of information he discloses, or fails to disclose, when filling out the application. The ISI WG also notes that ERL can be hard to locate through the policy wording. There is no standardized presentation of ERL making it difficult for consumers to locate them.

## **Coverage & Claims**

### **Post Claim Underwriting (“PCU”)**

Coverage under an ISI policy is often evidenced by the delivery of policy or certificate documents. However, due to the abbreviated nature of many application forms (as discussed above) the mere delivery of these documents does not necessarily mean the consumer has the coverage he thinks he has. In some cases the consumer, or his heirs, will not know that he wasn’t actually eligible for coverage until after a claim is filed.

Post-claim underwriting (“PCU”) is a practice of some insurers where they look into the basic eligibility of the consumer only after a loss has occurred. Then, if the insurer then finds a difficulty with the consumer’s basic eligibility, the contract is cancelled *ab initio*. In other words, the insurer decides that there never had been a contract at all.

There is concern that an insurance company may issue a policy based on the consumer’s responses to health-related questions without undertaking any independent investigation of the consumer’s medical history, even though the answers to some medical questions may invalidate the insurance. The insurer conducts the underwriting investigation to validate whether the insured actually qualified for coverage only when a claim occurs. Should there be, according to the insurer, a material misrepresentation, coverage is rescinded. In extreme situations, coverage could be rescinded based on facts that have no direct link to the claim made.

The effect of PCU on life insurance in such circumstances can obviously be devastating, but it is also a concern in disability and health insurance. Cancelling such contracts after a claim has been made obviously deprives the consumer of his expected coverage, but it also deprives him of the opportunity to seek an alternative coverage, as he might have done had he known that coverage had been refused when he first applied. With PCU, consumers can then find themselves in a situation where finding a new insurer to cover their insurance needs is unrealistic because their insurability has deteriorated.

Another concern is that PCU can include situations where coverage is adjusted according to the consumer’s circumstances when the loss occurs (e.g. the adjustment of disability insurance benefits to reflect the insured income when the loss occurred). This, too, can lead to

expectation gaps if the consumer did not have a good understanding of the policy when he bought it.

### **Pre-Existing Conditions**

In the case of pre-existing conditions that limit coverage, the insurer accepts that there was an insurance contract in place, but the adjudication is for the purpose of determining whether or not the contract covers the particular loss. If the cause of loss pre-existed the policy, or does not fall under one or more of the types of losses covered by the policy, there is still a contract in place, but there may be no amount payable because the terms of the contract limit or preclude recovery (e.g. if a consumer has a pre-existing heart condition, his loss would not be covered if he had a heart attack but would be covered if it came about from an unrelated cause).

Using pre-existing conditions to limit a policy's coverage is a valid insurance practice, but it can be misused. The ISI WG believes that proper disclosure and plain language are key to assisting consumers in making an informed decision regarding their insurance coverage if they have a pre-existing condition.

### **Potential Conflicts of Interest**

Considering how conflicts of interest are managed is inherent to a regulator's consumer protection role.

CCIR and CISRO, through the work of the Industry Practices Review Committee ("IPRC"), have conducted a review of how conflicts of interest are managed and disclosed in the traditional modes of distribution. The ISI WG notes that the findings of this review may be applicable to the ISI environment as well.

The principles for the management of conflicts of interest in the insurance industry that can be applied to the sale of incidental insurance products are:

- Priority of the client's interest;
- Disclosure of conflict or potential conflicts of interest; and
- Product suitability.

In order to ensure compliance with all applicable regulation, as well as ensuring best practices through compliance with the three principles identified by the IPRC and supported by all jurisdictions, some enforcement mechanism is necessary.

Priority of client's interest, like product suitability which we dealt with above, is based on the nature of the relationship between the seller and the consumer. Conflicts of interest are present when the seller has a monetary interest in whether a product is purchased. Such conflicts can result in harm to the consumer if product representations are not accurate, and sellers or insurers are not accountable for representations.

A seller may have a conflict of interest if he or his organization has the ability to set the price of the insurance, receive additional benefits beyond the regular commission (i.e. overrides, dividends, ownership interests in the insurer or reinsurer etc.) or if there is a possibility to enter

in a situation of tied selling.<sup>3</sup> In certain instances, ISI products may represent a major income stream for the sellers. Disclosure to the consumer of the seller's interest in the sale is one effective way to manage these conflicts.

The ISI WG notes that claim handling processes may also be a source of potential conflicts of interest for sellers and other parties not directly under regulatory control. A conflict can occur when sellers or third party administrators adjust claims under the insurance product sold. For instance, depending on the financial arrangements between the seller and the insurance company, the seller may face a conflict between their own best interest and that of the consumer. As well, depending on the financial arrangements in their contract, a third party administrator, contracted either by the insurer or master contract holder to handle claims reporting and claims adjustment, may face conflicts between their own best interest and that of the consumer. The use of third party administrators in the handling of travel insurance claims or claims involving other types of ISI products is very common.

## **Disclosure Requirements**

To make appropriate decisions, consumers should have access to all the information required to self-assess suitability, to evaluate the actual or potential conflicts of interest and to consider the impacts PCU and pre-existing conditions may have on their coverage and financial plans.

Disclosure of important policy terms, ERL and conflicts of interest can take place verbally, through the written application process or can be accomplished through the written policy or certificate issued to the insured. An example of specific regulated disclosure requirements in the sale of incidental insurance can be found in ss. 15 and 16 of Alberta's *Insurance Agent's and Adjusters Regulation*, A.R. 122/2001. These sections notably require that, at the time the consumer applies, the seller must provide the consumer with a summary of the terms of the insurance offered, a summary of the circumstances under which the insurance commences or terminates, the procedures to follow in making a claim and to notify the consumers that the policy, or in the case of a contract of group insurance, a certificate will be sent to him.

While most regulators prohibit certain tied selling practices and mandate the disclosure of any compensation, inducement or benefit paid to the seller, explicit disclosure regulations to manage existing or potential conflicts of interest do not exist in every jurisdiction. For example, incidental sellers may not be obligated to inform potential consumers of business relationships between them and the insurer that could give rise to potential conflicts of interest.

The ISI WG note that in some ways the application forms for ISI products could hold the most promise in terms of appropriate disclosure to the consuming public.

## **Industry Guidelines**

Some industry associations provide guidelines for insurers and sellers to help them ensure that disclosure requirements provide for fair treatment of consumers in ISI business. Given the nature of the requirements contemplated in this paper, the ISI WG notes that these guidelines may need to be enhanced.

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<sup>3</sup> Most jurisdictions prohibit certain tied selling practices.



## **Training & Supervision**

At the broadest level, the expectation of regulators regarding supervision, education and training of sellers of ISI products is that sellers will be effectively supervised and that sellers will be trained and will possess sufficient knowledge to provide accurate and complete information to consumers who are considering the purchase of insurance products. This could include the understanding and ability to explain eligibility criteria and to differentiate conditions or losses that would not be covered in any event, such as ERL, from those not covered because of pre-existing conditions. Sellers should also be trained to a level that they could adequately explain the application process, the manner in which claims are to be submitted and handled, and how policy refunds are calculated in the event of policy-cancellation or rescission. This can be accomplished through a number of means and depends on the ultimate type of regulation that is implemented.

Some regulators impose formalized instructions and examinations similar to those found in more traditional modes of insurance distribution and licensing models. For example, travel insurance agents selling travel insurance in British Columbia are required to pass an industry-developed examination and to comply with a continuing education requirement. This ensures a certain degree of competence in the products offered.

In other jurisdictions, requirements as to education and training are more generic in nature. For example, s. 486 of Alberta's *Insurance Act* mandates that distributors – sellers - and the insurers whose products are being sold "[...] establish reasonable procedures to ensure that personnel marketing insurance...are knowledgeable about the insurance being marketed, and [...]use those procedures." The exact degree of knowledge is then left to the discretion of the insurer and sellers but can be verified and policed by the regulators. Quebec has a similar provision that also requires the insurers to prepare a distribution guide intended for consumers and to file it with the regulator.

## **Availability of Statistical Information**

As noted at the beginning of this paper, statistics purely about the ISI distribution channel are not available. None of the reporting currently required from insurers isolates the information pertinent to ISI from their other activities. The current quarterly and annual statements and exhibits required from insurers do not split out insurance transactions arising from ISI distribution channels. As well, the current complaint reporting mechanisms do not identify complaints by distribution channel. Thus, it is difficult for anyone to make definitive statements about the extent of ISI business being written in Canada, the kinds and number of complaints it generates, or even which insurers are active in this distribution channel.

In order to establish trends, to assess the regulatory risks inherent to ISI and to establish an adequate level of monitoring of this business, regulators would need statistical information broken down by distribution channel at regular intervals. As some provincial companies are deeply involved in ISI, the information CCIR would be looking for would have to be gathered from both federally and provincially registered companies.

Among the information about ISI distribution channel CCIR would need from insurers would be:

- Amount of premiums per year, gross and net of reinsurance;
- Number and value of claims per year (accepted/denied);

- Details on reasons for denials;
- Loss Ratio;
- Actuarial reserves and reserving practices;
- Commissions and fees paid to and by insurers; and
- Complaints and complaints resolution.

We understand that the structure of some ISI groups allows the incidental seller to set prices and earn fees and commissions above the amounts to be paid to the insurer. In such situations, the insurer acts as a wholesaler and the seller as a retailer selling a marked-up product. Details of these fees and commissions would be required for regulators to gather a complete picture of this business from a consumer protection point of view.

## Part 2 – A Constructive Discussion on How to Address Known and Potential Issues

As in Part 1 of this document, this section is intended to create a constructive discussion around potential policy options and ways to address the issues. The options presented are not intended to be exhaustive.

**Please provide comments/feedback on the options presented or suggest any different approach you feel should be considered in this review.** Where possible, questions have been posed to stimulate discussion on specific issues.

### Exclusions, Restrictions and Limitations (“ERL”)

- The application forms for ISI products could be used to ensure more appropriate disclosure to consumers. Insurers could be required to include more expansive questions in application forms so that conditions listed as pre-existing conditions are raised directly with the consumer at the time at which the application is being made.
- Post-claim underwriting could be limited by requiring insurers to specifically deny coverage within a certain period of time if they are concerned with anything on an application or are dissatisfied with the answers provided by the insured.

Considering the above, please give us your comments on the following questions:

1. Other than through the application form, are there other ways to ensure adequate consumer disclosure?
2. Should insurers be required to assess eligibility for coverage more extensively, and how long should insurers have to assess eligibility?
3. If post-claim underwriting was deemed acceptable in specific situations, how should consumers be informed of it?
4. How should ERLs applicable to group insurance policies be disclosed to consumers?

### Managing Potential Conflicts of Interest

- Sellers could be required to disclose any financial or other interest they directly or indirectly have in the sale of insurance and who is responsible for setting the rates quoted to the consumers.
- Insurance companies could be required to set the rates that sellers, such as lending institutions and retailers, charge for the insurance.
- A licensing regime could be implemented, whether in a full or a restricted capacity, as a tool to provide regulators with the necessary means to deal with conflicts of interest.

Considering the above, please give us your comments on the following question:

5. What is the most effective way to disclose any potential conflicts of interest?

## Role and Responsibilities of Incidental Sellers and Insurers

- Formalized instruction and examination programs for sellers, similar to those found in more traditional modes of distribution could be developed and implemented.
- Insurance companies could be held more accountable for the actions of sellers in the event of misrepresentation during enrolment under contracts issued by the insurance company.
- For group insurance, accountability at the level of the master contract holder level could be established by requiring them to be licensed.
- Insurers could be required to put more rigorous compliance programs in place, including on-site supervision of sellers and a continuing education program on their products.
- Plain language disclosure requirements could be imposed in order to ensure consumers would have relevant information to self-assess product suitability and to be able to consider actual or potential conflicts of interest.
- Licensing, whether in a full or a restricted capacity could be considered as a tool to provide regulators with the necessary means to enforce acceptable standards of practice.

Considering the above, please give us your comments on the following questions:

6. What is the most effective mechanism for ensuring an appropriate level of product knowledge by sellers?
7. Are consumers in a position to be adequately informed about their decision to purchase ISI products? Consumers may rely on information provided by ISI sellers to make these decisions. What form of regulatory environment would be the most appropriate to enforce acceptable standards of practice?
8. Should ISI sellers be subject to supervision by the insurers? If not, by whom?

## Availability of Statistical Information

- ISI WG feels that additional statistical information on ISI is required in order to better understand this sector of the market.

Considering the above, please give us your comments on the following questions:

9. What is the best way for insurers to report information pertaining specifically to ISI?
10. What challenges would insurers face in having to comply with a new reporting requirement pertaining specifically to ISI?

## Making Your Submissions

The ISI WG welcomes the comments, suggestions and ideas of the industry and consumers associations on the issues described in this consultation document.

An electronic copy of this consultation document is available on CCIR's website at [www.ccir-ccra.org](http://www.ccir-ccra.org). We look forward to receiving your submissions by April 28, 2008. 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 this consultation document should not be construed as the official position of any provincial, territorial or federal government or agency.