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Subject: Managing Conflict of Interest Risk in Relation to Incentives

Independent Financial Brokers of Canada (IFB) is pleased to provide our comments on this Issues Paper published by the AMF in July 2017.

Who we are

IFB is a national, not for profit, professional association representing approximately 3,500 licensed financial advisors. IFB members are self-employed and, for the most part, run small to medium-sized businesses. Every day, they assist a diverse population of clients and their families in communities across Canada with setting and achieving financial and estate planning goals that will help secure their financial future.

IFB members have chosen to be independent so they can offer clients advice on financial products and services from more than one company. IFB does not represent company or bank employees, or advisors who work in an exclusive relationship with one company.

An important part of the work IFB does is to advocate on behalf of our members for a well-regulated industry that recognizes the value that independent advice brings to clients of all financial means. In doing so, IFB regularly engages with provincial securities and insurance regulators, the CCIR, CISRO, CSA, provincial and federal governments, and other industry stakeholders.

Although some IFB members are general insurance brokers, the majority are life/health insurance licensed and mutual fund representatives. Therefore, our remarks will address the issues raised in this paper, as they pertain to life insurance.

Our comments

As the Paper states, compensation practices within the financial services industry have been receiving regulatory attention for some time – in Canada and internationally. In Canada, the CSA has been consulting on options to better manage the potential conflicts of interest raised by compensation paid to firms and advisors. This includes a ban on embedded commissions, like trailer and DSC fees.

IFB responded to these consultations cautioning against a ban. In our view, the risk of a ban leading to an advice gap – particularly for more vulnerable consumers – is too high. Instead, we supported many of the CSA's proposed targeted reforms to manage conflicts, better regulatory guidelines, and improved transparency.

In a past survey of members, many members told us that clients are not concerned about how they are paid. Clients are concerned about purchasing the right product, staying on track to meet their goals, and their investment returns. In other words, any policy that focuses exclusively on the cost of advice (inclusive of all compensation) will neglect the many other real benefits that accompany that advice.

Insurance is predominantly sold through advisors, and insurers must find ways to motivate their sales force, while ensuring their representatives are well trained and competent. There also has to be an attraction for the industry to recruit new entrants.

IFB supports the fair treatment of consumers, and the role advisors play in ensuring this happens, as they are the primary contact for clients. However, IFB has also encouraged regulators, in past submissions, to look beyond the advisor-client relationship, to consider a more fulsome review of conflicts. In particular, we noted the structural conflicts that arise from companies' incenting employees and advisors to sell their products. Insurance companies today offer a more complex array of wealth management products, in addition to traditional life insurance, have shareholders, and are profit-motivated.

Principles based approach to conflict management

In general, IFB supports principles-based regulation because it is more adaptable to changing market technologies, products and innovation, than is a prescriptive approach. As stated in the Paper, all forms of compensation in a sales environment can have the potential for a conflict, but the risk of that conflict resulting in poor consumer outcomes can vary. Under a principles-based approach, regulators can set out the obligations of companies, MGAs, and other intermediaries, while allowing flexibility on how an expected or positive outcome can be achieved.

With the rising influence of fintech, many firms are investing in technology that may well change how products are made available to the public. At the same time consumers, especially younger people, expect to be able to transact, review account information and correspond in an increasingly mobile way. Regulations which are not flexible enough to easily transfer between this digitized environment, and the more traditional paper-based one, will create challenges that are likely to limit innovation and growth. Many consumers expect their advisor to be able to provide their services using both types of platforms in a barrier-free way.

Proprietary sales

We note that securities regulators have raised particular concerns about the conflicts presented by firms which only sell proprietary products, or provide an open shelf but incent sales (through higher payouts) of their proprietary products. Such instances have been documented by the CSA[1], and have prompted follow up by both IIROC and the MFDA.

[1] CSA Staff Notice 33-318. https://lautorite.qc.ca/fileadmin/lautorite/reglementation/valeurs-mobilieres/0-avis-acvm-staff/2016/2016dec15-33-318-avis-acvm-en.pdf

More recently it has become very apparent that there are serious flaws in the fair treatment of bank customers, as articulated in the CBC's *Go Public* revelations by bank employees. This has led to Senate hearings, the FCAC investigations and OFSI's review of retail sales practices.

Allegations of improper sales practices, hidden fees, and production pressures on frontline employees speak to the need for improved governance practices and better alignment of the corporate culture with the fair treatment of consumers. Integrated financial institutions benefit from ongoing contact with individuals and businesses who deal with them on a regular basis. This provides them with the opportunity to continually up-sell and cross-sell, which magnifies the impact of improper practices for consumers.

New Zealand's Financial Markets Authority observed in its 2015 "Report on Sales and Advice" that: *Vertically integrated distribution models, where a business is the provider, manager and distributor of a product, can exacerbate conflicts of interest. Remuneration and incentive arrangements can also reinforce conflicts of interest, particularly when sales staff are remunerated on a volume basis or through certain bonus structures*.

This same structure, of course, exists in Canada, and we believe merits the attention of regulators and policy-makers.

We generally agree that salary paid to employees, when not linked to the sale of a product, is low risk. However, it has become apparent, as evidenced by the allegations publicized by the CBC, that some salaried employees are also pressured to meet sales thresholds to keep their position, or earn a salary increase. Production may be tied to other incentives, like stock options, profit sharing, etc. Where this is the case, the level of risk may be more aligned with that of a commissioned salesperson.

<u>Training</u>
IFB members report that insurers are doing less training. In some cases, they download this to the MGAs; however, it has been cited as a weakness by members responding to an IFB survey. This was noted as especially important for newer advisors or when new products are launched.

<u>Fees</u>
We agree that fees can be low risk. However, this may not be the case if the fee is linked to the sale of a product, or size of the investment account placed with the advisor. It has been noted in some studies that consumers are less likely to attempt to negotiate a fee, or recognize when a fee is inappropriate relative to the level of service being provided. In these cases, the risk to consumers is heightened.

<u>Commissions</u>
Upfront commissions paid to intermediaries based on the sale of an insurance product is the standard form of remuneration in the life insurance industry. As noted above, when an insurer pays a higher commission, most commonly to promote the sale of proprietary products, the risk increases. One solution being considered for mutual fund products is to cap or standardize commissions – thereby removing the incentive to sell a product with a higher commission over a lower priced one. Arguments countering this position suggest that some products are sold with a higher commission in consideration of the type and complexity of the investment product.

Accepted industry procedures to claw back commissions under certain instances provide a counterbalance to the risk. When advisors place business with multiple insurers, the risk is also lessened.

Titles, sales contests, other benefits

As noted, some insurers have discontinued offering conference and travel incentives. IFB supports restrictions on the use of titles which do not reflect proficiency or accreditation earned. As noted in the Paper, titles can be misleading to consumers when they perceive that the title is linked to competence, rather than sales volume.

Some companies provide high income advisors with access to preferred programs, such as paid errors and omissions insurance. Given the cost of compliance oversight, some insurers are terminating contracts with low-producing agents.

Concluding remarks

IFB believes that reviewing conflicts arising from structural incentives is essential to understanding the overall risk to consumers transacting in the life insurance industry. The responses to this Issues Paper, along with the results of the CCIR market conduct survey, will provide a more complete assessment of the need for regulatory attention.

The life insurance industry has demonstrated its ability to work collaboratively with regulators to find acceptable solutions. IFB looks forward to continuing this approach to support our members, and other industry stakeholders, to ensure consumers can be confident in the advice they receive.

Please contact the undersigned, or Susan Allemang, Director, Policy & Regulatory Affairs (email: sallemang@ifbc.ca), should you have questions or wish to discuss our remarks.

Yours truly,

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