Incentive Management Guidance

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A. Definitions/Concepts

In this guidance, the following terms are used as defined below:

"**Insurer**" includes the various entities registered to do insurance business within any jurisdiction.

"**Intermediary**" is given a broad meaning. It encompasses individual agents, brokers and representatives ("representatives") as well as the business entities that are authorized to distribute insurance products and services, including managing general agencies, third party administrators and national accounts, as the case may be.

In Canada, Intermediaries that are subject to licensing and supervision can vary from jurisdiction to jurisdiction. This guidance applies to all Intermediaries that are authorized to do business within any jurisdiction, whether licensed, registered or exempted from registration.

"**Customer**" refers to policyholder (which, as the case may be, includes certificate holder) or prospective policyholder with whom an Insurer or an Intermediary interacts, and includes, where relevant, other beneficiaries and claimants with a legitimate interest in the policy.

"**Incentives**" are monetary and non-monetary compensation offered by Insurers or Intermediaries to their employees (including front line staff and management) and other persons or entities acting on their behalf in the sale and servicing of insurance products.

Monetary Incentives include, but are not limited to, commissions paid based on sales and services expected and provided (e.g. initial sales, renewals, trailers) and bonuses paid on achievement of performance targets (e.g. number/dollar volume of sales, retention, growth, fair treatment of Customers).

Non-monetary Incentives include, but are not limited to, non-cash benefits, rewards and privileges such as travel, goods and hospitality, entertainment, memberships, contest entry, Insurer client referrals and access to services that are related to performance targets.

Incentives arise primarily from established compensation and performance management programs and relationships between Insurers and Intermediaries and any other person acting on their behalf.

"**Performance management programs**" are measures, targets and criteria established by Insurers and Intermediaries to evaluate the performance of an individual or an entity in the sales and servicing of products in order to grant Incentives. Criteria can be quantitative reflecting financial contribution (e.g. sales volumes, profitability, productivity) or qualitative reflecting the fair treatment of Customer (e.g. results of post-sale controls, quality of behaviour with Customers, Customer satisfaction, number and types of complaints received and other key indicators).

"Incentive arrangements" means primarily the Incentive itself, the Performance management program associated with it and various features related, for example, to payment or deduction of the Incentive.

B. Preamble

This guidance sets out the expectations of the Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organizations (CISRO) for the management of Incentive arrangements related to the sale and servicing of insurance products. It is intended to complement the *CCIR and CISRO Guidance Conduct of Insurance Business and Fair Treatment of Customers* (CCIR/CISRO FTC Guidance)[1], and ensure Incentive arrangements implemented by Insurers and Intermediaries align with fair treatment of Customer (FTC) principles. The guidance aims to ensure that Insurers and Intermediaries develop Incentive arrangements that achieve FTC. Insurers and Intermediaries are expected to put in place risk management policies, procedures and controls in order to meet their obligations in this regard.

Although this guidance sets out expectations to ensure Incentive arrangements do not undermine FTC, it recognizes that Insurers and Intermediaries compensate employees and other persons or entities acting on their behalf in the sale and servicing of insurance products.

This guidance provides Insurers and Intermediaries with the necessary latitude to determine the requisite strategies, policies, processes, procedures and controls in order to facilitate achieving such results and to apply them based on the nature, size and complexity of their activities, while taking into account representatives' regulatory obligations in order to facilitate achieving the Customer outcomes reflected in this guidance.

In Canada, the conduct of business in insurance is regulated by individual provinces and territories, where each jurisdiction has its own regulatory approach based on its legal framework and culture. The expectations in this guidance do not supersede the legislative and regulatory imperatives of jurisdictions; they are intended to support Insurers and Intermediaries in achieving FTC and while respecting existing laws and regulations.

1 See section 6.2 of the CCIR/CISRO FTC Guidance.

C. Scope

This guidance applies to Insurers and Intermediaries that pay compensation and/or design Incentive arrangements.

The Insurer is responsible for FTC throughout the life-cycle of the insurance product, as it is the Insurer that is the ultimate risk carrier. The Insurer's ultimate responsibility does not absolve Intermediaries of their own responsibilities for which they are accountable. Treating Customers fairly is a shared responsibility when Insurers and Intermediaries are both involved.

Representatives who operate under an Incentive arrangement are expected to comply with their obligations to manage conflicts of interest and their duty to prioritize Customers' interests as described in the CCIR/CISRO FTC Guidance.

This guidance applies to all insurance products, types of insurance, and distribution channels.

1. Governance

CCIR and CISRO expect Insurers and Intermediaries' governance and business culture to place FTC at the center of decisions concerning the way Incentive arrangements are designed and managed.

Incentive arrangements reflect the values and objectives Insurers and Intermediaries want to achieve and are key elements in establishing a business culture. They can demonstrate the importance that an Insurer or Intermediary places on FTC. Incentive arrangements should not be detrimental to FTC.

Overall responsibility for FTC is at the level of the board and/or senior management, who design, approve, implement and monitor adherence to policies and procedures aimed at ensuring that Customers are treated fairly.[2]

Expectations to achieve this outcome (Insurers and Intermediaries)

1.1 Oversee strategy, risk appetite and culture in relation to the design and implementation of Incentive arrangements.

1.2 Develop policies, procedures and controls which ensure FTC outcomes are integrated into Incentive arrangements.

1.3 Ensure the policies, procedures and controls take into consideration the identification and assessment of the risks of unfair outcomes to Customers which may arise from Incentive arrangements.

1.4 Ensure the policies, procedures and controls are monitored periodically for continued effectiveness in identifying, assessing, monitoring and mitigating risks of unfair outcomes to Customers.

1.5 Review Incentive arrangements periodically and implement any changes required to manage risks related to the FTC. This should take into consideration input from the appropriate business functions (e.g. risk management, compliance, legal and human resources).

[2] See section 6.1 of the CCIR/CISRO FTC Guidance.

2. Design and management of Incentive arrangements

CCIR and CISRO expect Insurers and Intermediaries to design and implement Incentive arrangements that include criteria ensuring FTC.

Insurers and Intermediaries are responsible for the Customer experience. If Incentive arrangements are properly designed and implemented, they can reduce the risk of unfair outcomes to Customers.

Expectations to achieve this outcome (Insurers and Intermediaries)

Design

2.1 The design process of Incentive arrangements ensures that:

2.1.1 any Incentive paid is consistent with the level of service expected and provided throughout the product's life cycle.

2.1.2 quantitative and qualitative performance targets and criteria are clearly defined, measurable and are aligned to ensure FTC.

2.1.3 the cost of the product to the Customer does not vary based on the distribution method.

2.2 Assessments of risks of unfair outcomes to Customers and results of controls are taken into consideration in the approach to and procedures for designing Incentive arrangements.

Management

2.3 Ensure that employees and other persons and entities involved are aware of Incentive arrangements applicable to them.

2.4 Use sufficient information/key indicators[3] in order to be able to identify potential risks of unfair outcomes to Customers as a result of Incentive arrangements.

2.5 Periodically review and when necessary improve controls taking into account the features of Incentive arrangements that increase the risks of unfair outcomes to Customers (e.g. post-sale controls based on customer files, controls to identify inappropriate practices that may occur during interactions with Customers).

2.6 Ensure corrective measures are taken when the controls detect inappropriate practices with Customers.

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[3] For example, sales patterns before and after a target has, or has not, been met, variations in the mix of products sold (to see if the commission grid influences the selection of product sold, if they consistently select one product over another); penetration rates for cross-selling, where indirect interest can be distinct from the client's interest; high lapse rates on new business; poor persistency rates comparing to persistency targets; accumulated chargeback debt; claims repudiation rates and the reasons for rejected claims; recurring sales related complaints; bias towards selling products that carry a higher level of incentive.

2.7 Establish appropriate consequences or deterrents to actively discourage behaviours that could cause unfair outcomes to Customers.

2.8 Provide arrangements for recovering, when appropriate, the compensation once it has been paid.

2.9 Promptly adjust or modify Incentive arrangement features when risks of unfair outcomes to Customers cannot be managed or monitored without ensuring FTC.

2.10 Subject any Incentive arrangements that may reasonably have an impact on FTC to the management of potential conflicts of interest.[4]

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[4] CCIR/CISRO FTC Guidance, section 6.2.

3. Risks of unfair outcomes to Customers

CCIR and CISRO expect Insurers and Intermediaries to regularly identify and assess the risks of unfair outcomes to Customers that may arise from Incentive arrangements so that either appropriate controls can be introduced or the Incentive arrangements can be adjusted.

Unfair outcomes are more likely to be present when Insurers, Intermediaries or any persons and entities acting on their behalf pay or receive Incentives for practices that fail to achieve expected FTC outcomes.[5]

Such risks may arise from the design of Incentive arrangements, issues specific to distribution methods and systems for reporting and controlling Customer outcomes.

The Appendix provides examples where components of Incentive arrangements which, without proper design, management and post-sale controls, may increase the risk of unfair outcomes for Customers.

Expectations to achieve this outcome (Insurers and Intermediaries)

3.1 Review on a regular basis and as needed Incentive arrangements with sufficient attention given to identify, understand and assess their specific features that may increase the risks of unfair outcomes to Customers.

3.2 Consider the risk that an unfair outcome may occur and its potential impact on Customers.

3.3 Include a proper consideration of the impact of Incentive arrangements that are primarily or solely based on quantitative performance criteria.

3.4 Consider Incentive arrangements granted by persons and entities acting on their behalf and if their combination with those from the Insurer or the Intermediary increases the risk of unfair outcomes, and share information with respect to the same transactions in order to enable Insurers and Intermediaries to meet this expectation.[6]

3.5 Consider the addition of different types of Incentives (commissions, bonuses, non-cash benefits, rewards and privileges) for the same basket of sales.

3.6 Consider the effects of time-limited sales campaigns and product promotions.

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5 CCIR/CISRO FTC Guidance

6 CCIR/CISRO FTC Guidance, Insurers are expected to have written agreements in place established in respect of their business dealings with each other, to clarify their respective roles and facilitate the achievement of expected outcomes in matters of FTC (Section 4 – Relationships between Insurers and Intermediaries). Insurers are accountable for distribution strategies and ultimately responsible for oversight aspects pertaining to the distribution of their products (Section 6.5 – Distribution strategies). Insurers and intermediaries' expectations related to Outsourcing (Section 6.3).

4. Post-sale controls

CCIR and CISRO expect Insurers and Intermediaries to establish effective post-sale controls to identify inappropriate sales resulting from Incentive arrangements.

Effective post-sale controls should facilitate Insurers and Intermediaries in:

- detecting unsuitable sales resulting from Incentive arrangements in order to make the required corrective action.
- determining residual risks of unfair outcomes to Customers.
- ensuring the design and implementation of Incentive arrangements achieve expected outcomes for FTC.

As the degree of risks in Incentive arrangements increases, the need for Insurers and Intermediaries to demonstrate the effectiveness of their controls in detecting unsuitable sales will also increase.

Expectations to achieve this outcome (Insurers and Intermediaries)

4.1 Ensure that persons conducting post-sale monitoring:

4.1.1 have the required competence and experience to understand the features of the applicable Incentive arrangements and the appropriate procedures to identify risks of unfair outcomes to Customers.

4.1.2 are sufficiently independent from the sales functions they are required to monitor to avoid being unduly influenced.

4.2 Ensure that risk-based post-sale controls are consistent with:

4.2.1 the assessment of risks of unfair outcomes to Customers that may arise from Incentive arrangements.

4.2.2 any high-risk concerns (e.g., persons, teams, entities, lines of business, geographic areas, departments, distribution channels, unusual sales spikes, sales practices) identified in the monitoring of information/key indicators.

4.3 Regularly review the results of post-sale controls to ensure that:

4.3.1 sales suitability is monitored closely.

4.3.2 post-sale monitoring focuses on significant risks of unfair outcomes to Customers.

4.3.3 Customer outcomes are assessed.

4.3.4 areas of concern or common issues that must be addressed are identified.

Appendix

Below are examples of components of Incentive arrangements which, without proper design, management and post-sale controls, may increase the risk of unfair outcomes to Customers.

Incentives

1. Bonus rates that increase with predetermined sales volumes thresholds without adequate consideration to FTC.

2. Excessive Incentives for cross-selling optional products compared to the Incentive for selling only the primary product.

3. Commissions linked to the premium level or the investment amount.

4. Renewal commission amounts that underestimate the level of continuing services, or discrepancies between commissions for initial sale and continuing services, which can cause Intermediaries to propose a replacement transaction in order to increase compensation.

5. Lifetime vesting of renewal commissions to Intermediaries which can result in eventual client orphaning.

6. Incentive arrangements which can result in fees or penalties, (e.g., exit fees) for the Customer.

7. Incentives paid to Intermediaries who are not involved in the sale and servicing, either provided or expected.

Performance criteria

8. Performance criteria primarily aligned with quantitative objectives.

9. Qualitative criteria that is ineffective or insufficient in aligning the interests of the Insurer and Intermediary with those of the Customer.

10. Sales contests, sales quotas, bonuses and non-monetary benefits that are based on sales of specific products over limited period of time.

11. Contests, campaigns, promotions, loyalty or recognition programs that are designed to increase sales volumes or meet other quantitative targets to obtain bonuses, rewards (e.g., titles, gifts, goods, hospitality, trips) or privileges (e.g., access to services).

Other features

12. Incentive paid in advance of the service expected or the achievement of performance targets.

13. Chargeback mechanism influencing the Intermediary to advise the Customer to maintain a product that is inappropriate, so that the Intermediary is not required to repay compensation.

14. Agreements with Intermediaries (e.g., distribution, contingent, financial support, access to IT platforms/software, profit-sharing programs, call centre), which may allow Insurers to influence the decisions, operations and practices of Intermediaries and restrict access to markets. For example, they could:

    - impose a minimum volume or a deadline for complying with a volume, include a bonus or a share in the profits based on contract experience or productivity-based loyalty programs that may affect the independence of advice given by Intermediaries or incentivize them to place all, or a majority, of their new business with a particular Insurer.

    - serve not only as trigger for receiving an Incentive, but also a gateway for signing a distribution agreement or obtaining financial assistance or a wide range of benefits over the long term.