AUTORITÉ DES MARCHÉS FINANCIERS

INCENTIVE MANAGEMENT GUIDELINE

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Introduction

The *Sound Commercial Practices Guideline* presents the outcomes expected from financial institutions in regard to their obligation to adhere to sound commercial practices and treat clients fairly.[1]

Among the expectations set out in the Guideline,[2] the AMF indicates that it expects any real or potential conflicts of interest to be avoided or managed in a manner that ensures the fair treatment of clients (FTC). The incentives awarded to a financial institution's staff, intermediaries or any other person acting on its behalf who is involved in offering its products and services are a major source of conflicts of interest.

This *Incentive Management Guideline* complements the *Sound Commercial Practices Guideline*. Accordingly, it adds to the expectations set out in the *Sound Commercial Practices Guideline* by presenting the AMF's expectations for financial institutions with respect to the way they manage incentive arrangements.

Financial institutions must avoid designing incentive arrangements that fail to ensure FTC. They must also implement risk management procedures and controls in order to fulfill their obligations in this respect.

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[1] *Insurers Act*, CQLR, c. A-32.1, sections 50 and 51;

Act respecting financial services cooperatives, CQLR, c. C-67.3, sections 66.1 and 66.2;

Trust Companies and Savings Companies Act, CQLR, c. S-29-02, sections 34 and 35; and

Deposit Institutions and Deposit Protection Act, CQLR, c. I-13.2.2, sections 28.11 and 28.12.

The generic term "financial institution" refers to all the entities that are subject to the legal obligation to adhere to sound commercial practices. Consequently, this term does not refer to a federation of mutual insurance associations.

Although the enabling statutes refer specifically to "clientele", this guideline uses the terms "client" and "clients" for consistency with the *Sound Commercial Practices Guideline*.

[2] Specifically, see section 6.2 of the draft updated *Sound Commercial Practices Guideline* currently in public consultation that was published in the AMF Bulletin dated October 21, 2021.

Concepts

Incentives

The incentives awarded to a financial institution's staff, intermediaries[3] or any other person acting on its behalf who is involved in offering its products and services fall into two main categories:

- Monetary incentives, including:
  - commissions paid based on services expected and provided (e.g., initial sales, renewal, trailers)
  - Bonuses and salaries paid on achievement of performance targets and criteria (e.g., volume of sales, retention, growth, FTC)
- Non-monetary incentives, including:
  - rewards or privileges (e.g., travel, goods and hospitality, entertainment, gifts, club or organization memberships, contest entry, client referrals, and access to services, conferences, seminars, conventions and other events) awarded on achievement of performance targets and criteria

Performance targets and criteria

Targets and criteria for measuring performance may be quantitative or qualitative:

- Quantitative performance targets and criteria reflect contribution to the financial institution's financial performance (e.g., sales volumes, profitability, productivity)
- Qualitative performance targets and criteria reflect FTC (e.g., based on results of sales quality controls, compliance with financial institution policies, disciplinary actions, complaints, client satisfaction)

Incentive arrangement

"Incentive arrangement" means the incentive itself, including any features related to payment or deduction of the incentive, and the performance targets and criteria associated with it.

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[3] Intermediaries are persons authorized to offer financial products and services pursuant to the *Act respecting the distribution of financial products and services*, CQLR, c. D-9.2.

1. Governance

> The AMF expects financial institutions' decision-making bodies to place FTC at the centre of decisions concerning the way incentive arrangements are managed.

Incentive arrangements reflect the values and objectives financial institutions want to achieve and are therefore key elements in establishing a business culture. Among other things, they demonstrate the importance that the financial institution assigns to FTC.

Policies, procedures and controls relating to incentive arrangements should therefore be closely monitored by the board of directors and senior management.

Among other things, the AMF expects the board of directors to:[4]

- Ensure that the committees responsible for monitoring changes in the business culture and identifying risks of practices that could adversely affect FTC are also responsible for ensuring that clients' interests are taken into account in managing incentive arrangements
- Ensure that changes are quickly made to incentive arrangements when FTC cannot be ensured
- Ensure that appropriate measures are taken with respect to the clients concerned when a practice that adversely affects FTC is identified

Among other things, the AMF expects senior management to:

- Develop and periodically review policies, procedures and controls related to incentive arrangements to ensure their continued effectiveness in managing risks of practices that could adversely affect FTC
- Review incentive arrangements periodically and at least once a year with the involvement of the risk management, compliance and human resources functions
- Assess the impact on the clients concerned when a practice that adversely affects FTC is identified and, when required, take appropriate measures

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[4] *Insurers Act, CQLR, c. A-32.1, section 94*
Trust Companies and Savings Companies Act, CQLR, c. S-29.02, section 75
Deposit Institutions and Deposit Protection Act, CQLR, c. I-13.2.2, section 28.38
Act respecting financial services cooperatives, CQLR, c. C-67.3, sections 66.1 and 99

2. Managing incentive arrangements

> The AMF expects incentive arrangements to be managed in a manner that ensures FTC.

Incentive arrangements arise primarily from the compensation and performance management programs implemented by financial institutions and the agreements entered into by them with intermediaries and other persons acting on their behalf who are involved in offering their products and services.

Incentive arrangements may vary depending on the nature of the financial institution's activities, the products or services offered, the distribution methods used, and the roles and responsibilities of the persons involved in offering products and services.

Financial institutions should manage incentive arrangements in a manner that prevents practices that could adversely affect FTC.

Financial institutions should also ensure that the incentive arrangements put in place by intermediaries or any other person acting on its behalf who is involved in offering its products and services are managed in a manner that satisfies their FTC-related obligations.

Expectations to achieve this outcome

- Establish an incentive mechanism design and review process that includes the following criteria:
  - Quantitative and qualitative performance targets and criteria are clearly defined and measurable and are balanced in a manner that ensures FTC
  - Any incentive awarded is consistent with the level of service expected and provided throughout the product's life cycle [5]
  - Incentive arrangements related to similar products[6] are comparable
  - Where incentives for the same product differ across distribution methods or intermediaries, they do not justify a difference in the cost of the product for clients
  - Incentive arrangements for the financial institution's managers[7] take into account their supervisory role and ability to influence staff, intermediaries or any other person acting on behalf of the institution who is involved in offering

[5] As indicated in the *Sound Commercial Practices Guideline*, the "life cycle of a product" means from product design to after-sale service.

[6] Products with features that can meet a client's needs and that involve the same level of service that is expected and provided. See example 2 in Appendix B.

[7] Excluding members of the board and senior management, key persons in supervisory functions, and major risk-taking staff, for whom expectations regarding the applicable remuneration practices are set out in the *Governance Guideline*.

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its products and services to prevent pressures from being exerted that could adversely affect FTC

- Ensure that staff, intermediaries or any other person acting on behalf of the financial institution who is involved in offering its products and services is informed in a timely manner of the incentive arrangements that apply to them
- Collect and use information and key indicators[8] to be able to identify:
    - Individuals, sales teams, lines of business and products most at risk of practices that could adversely affect FTC
    - Trends, unusual sales spikes and practices that could adversely affect FTC
- Implement, periodically review and, when required, improve controls while taking into account the identification and assessment of risks of practices that could adversely affect FTC and the assessment of results of controls
- Take appropriate measures to correct practices that could adversely affect FTC, including:
    - Ensuring feedback when controls detect an inappropriate practice in interactions with clients
    - Implementing appropriate measures, particularly at the human resources level, to demonstrate that practices that could adversely affect FTC are unacceptable
    - Making the necessary corrections to incentive arrangements
    - Establishing chargeback mechanisms so that incentives can be clawed back, if necessary, after they have been awarded

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[8] Appendix A: Examples of information/key indicators

3. Identification and assessment of risks of practices that could adversely affect FTC

The AMF expects financial institutions to identify and regularly assess the risks of practices that could adversely affect FTC arising from incentive arrangements.

The risks of practices that could adversely affect FTC may arise, in particular, from the design of incentive arrangements, characteristics specific to financial institutions' business models[9] and the inefficiency of the information systems and controls in place.

Appendix B in this Guideline provides a non-exhaustive list of examples of incentive arrangement features that increase the risks of practices that could adversely affect FTC.

Expectations to achieve this outcome

- Review the incentive arrangements regularly in order to assess the various arrangement features
- Give particular focus to incentive arrangements based primarily on quantitative performance targets and criteria
- Among other things, consider:
  - The combination of different types of incentive arrangements for the same sale
  - Sales campaigns focused on particular products
  - Incentive arrangements implemented by intermediaries or any other person acting on the financial institution's behalf
- Assess the likelihood of practices that could adversely affect FTC occurring while taking into account existing controls and their potential impact on clients

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9 For example, if the financial institution designs and sells its own products, if it controls the firm that distributes its products or if its products are distributed by independent firms, if it outsources some of its activities to a service provider, etc.

4. Quality monitoring

The AMF expects financial institutions to have controls in place to identify any inappropriate sales or practices with clients that may result from the implementation of incentive arrangements.

Financial institutions should apply continuous controls and post-controls to, in particular:

- Detect inappropriate sales and practices with clients in order to take the required corrective actions
- Determine residual risks of practices that could adversely affect FTC
- Ensure that the incentive arrangements as designed enable the achievement of the expected FTC outcomes

The greater the risk that the incentive arrangements will result in practices that could adversely affect FTC, the greater the expectation that the financial institution will ensure the effectiveness of its controls.

Expectations to achieve this outcome

- Make sure that staff conduct sales quality monitoring[10] have the required competencies and experience and have the requisite independence to carry out their functions
- Make sure that sales quality monitoring takes into account:
  - The identification and assessment of risks that practices that could adversely affect FTC will result from incentive arrangements
  - The analysis of the information and key indicators collected
- Use various types of controls to assess staff interactions with clients [11]
- Analyze the results of sales quality controls on a regular basis to ensure that they:
  - Focus on risks of practices that could adversely affect FTC
  - Enable the assessment of FTC outcomes
  - Identify concerns or issues requiring corrective action by the financial institution to ensure FTC

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[10] By, among other things, analyzing sales records.

[11] For example, observing or listening to interactions with clients when products and services are being offered, mystery shopping, client surveys.

Appendix A

Examples of information/key indicators

This list of examples is not exhaustive. The examples come from various sources, including work carried out by the AMF in the context of its oversight and supervisory activities.

To determine which individuals or sales teams are most at risk of practices that could adversely affect FTC, identify those:

1. For which monetary incentives are a substantial component of total remuneration
2. For which products with higher commission rates represent a higher-than-normal percentage of sales
3. Who sell products to clients who do not fall within the defined target client groups for the products
4. With frequent chargebacks owing, for example, to products being cancelled shortly after they are sold
5. Who are the subject of repeated complaints from clients
6. With high lapse rates on new business or unusually high lapse rates compared to industry averages
7. With high penetration rates for cross-selling
8. With an unusually high number of product replacement transactions
9. Whose sales or practices are the subject of reports or measures by quality monitoring staff
10. For which there is little variety in the products sold

To determine which sectors and products are most at risk of practices that could adversely affect FTC, identify those:

11. With higher sales incentives
12. With sales incentives that are higher than for other similar products
13. For which sales campaigns are carried out or for which there is a sales spike
14. With higher than normal lapse rates
15. With fairly low renewal rates
16. With unusually high claim denial rates (total or partial)
17. Whose sales increase during specific periods, such as the bonus calculation period

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Appendix B

Examples of incentive arrangements features that increase the risks of practices that could adversely affect FTC

This list of examples is not exhaustive. The examples are taken from various sources, including work carried out by the AMF in the context of its oversight and supervisory activities.

Incentives

1. Higher bonus rates with higher sales volumes
2. Different incentives for similar products (risk of the more lucrative product being sold rather than the product that is best suited to the client's needs and situation)
3. Additional incentives based on extra product options or features
4. Salaries increased or decreased, benefits awarded or withdrawn or any penalty imposed (e.g., dismissal) depending on whether primarily quantitative performance targets and criteria are met or not
5. Bonus paid on each sale above a set threshold. Individuals could seek to complete as many sales as possible before the end of the bonus calculation period
6. Commissions paid for ongoing services[12] that are inconsistent with the level of service expected
7. Significant difference between initial sales commissions and commissions paid for ongoing services, which could lead individuals to propose a replacement transaction with no clear benefit for the client in order to maximize their remuneration
8. For the same product, commissions that are different for sales of new insurance contracts than for renewals of existing contracts
9. Incentives awarded for a given product that differ from one distribution method to the next (e.g., through a distributor or through a representative)
10. Incentives awarded for sales of a specific product for a limited period of time

Performance targets and criteria

11. Quantitative performance targets and criteria that are factor heavily in awarding incentives
12. Weight given to performance criteria and targets reflecting FTC not sufficient to have a real impact on the awarding (or clawback) of incentives established based on performance targets and criteria contributing to the financial institution's financial performance
13. Performance targets or criteria that are ineffective for measuring or ensuring the achievement of the expected FTC outcomes
14. Use of group targets and criteria to measure performance without sufficient weight being assigned to individual performance with respect to FTC

[12] E.g., renewal commissions, trailing commissions.

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15. Manager incentive arrangements that focus on quantitative performance targets and criteria
16. Incentive arrangements for debt collection staff that focus on the amount they collect (quantitative performance targets and criteria that increase the risk of staff engaging in inappropriate debt collection practices)
17. Performance measurement criteria that include cross-selling objectives

Other features

18. Monetary incentives representing a significant portion of a person's remuneration package
19. Renewal commissions are vested for life and paid to inactive, replaced or retired intermediaries (may result in clients being "orphaned" and in a new intermediary attempting to sell another product to them in order to earn remuneration)
20. Agreements with intermediaries (e.g., distribution, financial assistance, access to IT platforms/software, call center) that allow financial institutions to influence the decisions, transactions and practices of intermediaries and thereby restrict intermediaries' access to markets

    For example:

    - Imposition of a minimum volume or a deadline for attaining a minimum volume
    - Inclusion of a bonus or a share of the profits based on contract experience

    Such arrangements could have an effect on the advice provided by intermediaries or incentivize them to place a majority of new policies with a specific insurer.

    The making of certain agreements (e.g., distribution, financial support, other long-term benefits) may also be contingent on the making of other agreements.
21. Incentive arrangements that could entail penalties or fees for clients, such as withdrawal fees
22. Chargeback mechanism that may influence practices. A person may, for example, induce a client to keep an unsuitable product in order to avoid chargeback
23. Incentives awarded on a discretionary basis
24. Incentive arrangements under which, for example, the sales commission may increase based on the interest rate negotiated with the client, the amount invested or borrowed, the amount of insurance coverage

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