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• CANADIAN LIFE INSURANCE REGULATION AND THE FAIR TREATMENT OF CUSTOMERS •

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To promote financial stability and public confidence, financial sector regulation focuses on both prudential and solvency requirements as well as market conduct expectations.

In Canada, provinces and territories oversee the sale of insurance and insurance intermediaries. Federal oversight is limited to the governance and prudential supervision of federally incorporated insurance companies. Some provinces have delegated prudential supervision of provincially chartered insurers to the federal regulator (the Office of the Superintendent of Financial Institutions or OSFI).

Provincial insurance regulators have published guidance on the topic of the fair treatment of customers (FTC Guidance). The FTC Guidance has generated discussion within the life insurance industry and between regulated entities and regulators as stakeholders try to develop a common understanding of expectations related to FTC and its implementation. There has also been some confusion about whether the FTC Guidance changes the legal relationship between a regulated entity and its customers.

This paper is intended to contribute to the discussion about FTC by analyzing the nature of life insurance regulation in Canada, exploring the origins of FTC as a concept, and outlining an understanding of the objectives that regulators are trying to achieve. This analysis concludes that the FTC Guidance should be understood to be an articulation of regulatory expectations that regulators will use as a supervisory framework to assist in their oversight of the market conduct of insurers and intermediaries. The analysis also concludes that the FTC Guidance in itself neither changes the legal relationship between a regulated entity and its customers nor imposes a legal duty to treat customers 'fairly'.

FAIR TREATMENT OF CUSTOMERS AND THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

FTC is a component of the Insurance Core Principles (ICPs)[1] that were adopted by the International Association of Insurance Supervisors (IAIS) after the global financial crisis of 2008-2009.

Established in 1994, more than 200 national and sub-national insurance regulators globally now

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participate in the IAIS on a voluntary basis. The IAIS sets standards that are used by its membership to promote effective supervision, to maintain fair and stable insurance markets that benefit and protect policyholders, and to contribute to financial stability. In 1997, the IAIS adopted the Insurance Supervisory Principles which, in 2000, were updated and renamed the Insurance Core Principles (ICPs). The ICPs are frequently updated by the IAIS.

The IAIS is an association that establishes standards and best practices for use by national and sub-national regulators. These standards and best practices do not have force of law unless a jurisdiction chooses to implement the standard through legislation, regulation, or supervisory practice. The IAIS:

- is not a regulator or legislative body;
- does not supervise or have authority over national or sub-national insurance regulators; and
- does not supervise insurers or intermediaries.

However, the Group of Twenty countries (G20)[2] and Financial Stability Board (FSB)[3] have established processes designed to encourage jurisdictions to adopt international standards for financial regulation including standards set by the IAIS. In 2010, FSB members committed to implement international standards and undergo an assessment under the IMF-World Bank Financial Sector Assessment Program (FSAP) every five years.[4] FSB member commitment to implement international standards is not legally enforceable and has been somewhat inconsistent.

The IAIS strongly encourages member regulators to voluntarily adopt and implement guidelines developed by the association and to work to have national regulations changed to align with standards articulated by the IAIS. This encouragement is especially strong for those regulators who actively participate in the IAIS standard setting process. The fact that national regulators are subject to FSAP review also encourages implementation of IAIS standards in domestic regulation and supervisory practice.

The IMF coordinated FSAP reviews of Canada in 2013 and 2019. This review included an assessment

of whether Canada has adopted international standards for insurance regulation of which FTC is a component.

The timing of implementation of FTC by insurance regulators across Canada suggests that the primary purpose of issuing the FTC Guidance is to implement the ICPs in Canada to ensure that Canada's regulatory system is aligned with international standards. Insurance regulators have informed the industry that the FTC Guidance was not issued in response to actual market conduct issues or problems in Canada.

REGULATION OF LIFE AND HEALTH INSURANCE IN CANADA

In Canada, insurance is a subject of provincial and territorial jurisdiction. Accordingly, the sale of insurance contracts is governed by provincial and territorial law. These laws require insurers and intermediaries to be licenced to sell insurance for specific risks in each province and territory in which they do business. Further, licencees are overseen by the insurance regulator in that province or territory.

The common law jurisdictions (all provinces and territories except Quebec) each implemented the Uniform Life Insurance Act in 1962 which was followed by implementation of the Uniform Accident and Sickness Insurance Act in 1970. While some jurisdictions have updated insurance legislation over the intervening decades, to a significant extent the laws governing life and health insurance in the common law provinces have remained harmonized since the Uniform Acts were passed.

Canadian insurance regulators have a long history of collaborating to coordinate and promote a harmonized supervisory framework. As early as 1917, several provinces formed an "Association of Provincial Superintendents of Insurance of the Dominion of Canada" which over time was renamed and eventually expanded to include all provincial and territorial regulators and to also include OSFI as an associate member. In 1989, the association adopted the name "Canadian Council of Insurance Regulators" (CCIR).

Provincial and territorial insurance regulators supervise the market conduct of the insurers and insurance agents doing business in their province or territory. Provinces and territories also regulate/oversee the corporate governance and prudential regulation of insurers incorporated in their province. OSFI oversees the governance and prudential regulation of federally incorporated insurers but does not supervise market conduct. Some provinces have delegated prudential supervision of provincially incorporated insurers to OSFI.

Historically, life insurance was sold by agents who were employees of the life insurance company. As an employer, the life insurance company was responsible for the conduct of its agents. Today, the majority of life insurance agents in Canada are not employees of one company but have the ability to sell products of several life insurers, contracting directly with the insurer or working through a corporate agency often called a Managing General Agent (MGA). The relationships between the insurer, agent and MGA are governed by contract. However, life insurers have retained some responsibility for aspects of the conduct of intermediaries acting as their agent insofar as they are representing the insurer in the sale of insurance products and providing service to customers in relation to the insurance policy.[5] This responsibility results in life insurers establishing processes to supervise the conduct of the agents who distribute their products. The common law responsibility means that life insurers may be sued by customers for damages arising from agent misconduct or negligence in the sale or servicing of the insurer's products.

The Canadian Life and Health Insurance Association (CLHIA) is a trade association that represents almost all life and health insurers licensed to do business in Canada. The CLHIA adopts guidelines that members are expected to follow as a condition of membership in the association. Unlike guidance issued by most trade associations, the CLHIA guidelines are considered quasi-regulatory by many insurers and many regulators. This is partially due to the fact that in the 1990s the CLHIA

assumed responsibility for maintaining supervisory guidance that had been previously issued by the CCIR. In developing or amending the CLHIA Guidelines, the association has traditionally sought input from the CCIR and many of the Guidelines have been adopted to address concerns or respond to issues originally raised or identified by CCIR. Many provincial regulators use the CLHIA Guidelines as evidence of industry best practice when overseeing insurer conduct, and regulators take a negative view of non-compliance with the Guidelines. In this way, CLHIA Guidelines have traditionally formed a part of the supervisory framework.

Regulatory guidance, like the FTC Guidance, is issued by CCIR or individual provincial or territorial regulators to articulate expectations and to provide regulated entities with a better understanding of how regulators will approach supervision. In regulating life insurance, provincial and territorial regulators generally take a principles-based and risk-based approach to supervision. This means that the regulator articulates expected outcomes but gives the regulated entities flexibility to implement processes designed to achieve those outcomes. Ongoing regulatory supervision often involves assessing whether a life insurer or intermediary has implemented effective strategies and whether they have processes in place to promote the outcomes expected by regulators.

FAIR TREATMENT OF CUSTOMERS: IMPLEMENTATION IN CANADA

Prior to the 2013 FSAP review of financial regulation in Canada, Quebec's insurance regulator, the Autorité des marchés financiers (AMF) issued the Sound Commercial Practices Guideline[6] (SCP Guideline) which is broadly consistent with ICP 19 and represented the first implementation of FTC principles in Canada. The SCP Guideline articulates the AMF's expectations about how financial institutions will conduct their business to achieve the fair treatment of customers.[7] Companies are expected to develop and implement strategies, policies and procedures that achieve the following 'commercial practices results':

- the institution's governance and corporate culture strongly support the implementation of measures designed to achieve the desired outcomes;
- new products are designed and marketed in ways that take into account the needs of the targeted customer(s);
- consumers have information that allows them to make informed decisions before, during and after purchase;
- compensation structures do not affect the achievement of the desired outcomes;
- marketing and advertising is accurate, clear and not misleading;
- both claims and complaints are examined diligently and settled fairly using a process that is simple and easy for clients to understand and follow; and
- personal customer information is protected appropriately.

The SCP Guideline notes that the AMF will supervise institutions to assess the effectiveness of the strategies, policies and procedures adopted and their oversight and controls in achieving the expected outcomes.[8]

Prior to the 2019 FSAPreview of financial regulation in Canada, the CCIR and the Canadian Insurance Services Regulatory Organizations (CISRO) issued guidance entitled "Conduct of Insurance Business and the Fair Treatment of Customers."[9] The FTC Guidance is based on the IAIS ICPs and is more detailed than the SCP Guidance but closely aligned with respect to the expected outcomes.[10] Like the IAIS, the CCIR is not a regulator but an association for Canada's provincial insurance regulators that, among other things, sets standards that guide supervisory practices. Many provincial insurance regulators have announced that they intend to incorporate the FTC Guidance into their supervisory framework.[11]

In 2002, the Quebec "Act respecting Insurers" was updated to state that insurers must adhere to sound commercial practices including properly informing persons being offered a product or service and acting fairly in dealings with them. The law was reformulated

in 2019.[12] The current Quebec law also requires that an insurer be able to demonstrate to the AMF that it is adhering to sound commercial practices. Insurers who fail to comply with these requirements may be subject to fines.

In 2017, provincial regulators began a review of several life insurance companies to assess how company business practices aligned with FTC guidance and regulatory expectations. In 2021, the CCIR published an Observations Report[13] setting out findings and making recommendations that provide more clarity about regulator expectations about how industry participants will structure their operations. The Observations Report provided additional detail about the types of practices regulators expect companies to have in place and found that insurers did not consistently have practices in place.

THE FAIR TREATMENT OF CONSUMERS AS A SUPERVISORY FRAMEWORK

Most provinces have adopted the fair treatment of customers into the supervisory framework by issuing or endorsing guidance that establishes regulatory expectations about the conduct of regulated entities.

There is an ongoing discussion within the sector and within the regulatory community about what should be done to implement FTC in the life insurance sector. As set out in the Observations Report, regulated entities already have many processes in place that align with FTC guidance — in relation to the handling of claims, complaints and customer information, for example — but there are opportunities to improve the consistency of practices within companies and across the industry.

Much of the guidance and ongoing discussion is focused on what insurance companies do in designing, marketing and selling products to customers, the ongoing interactions post-sale, and the eventual payment of insurance benefits. This has been described using the terms "customer journey" or the "product lifecycle." There is an effort to examine each stage of the customer journey and identify outcomes that would align with FTC. Industry participants would then examine what types of practices and processes they have in place to promote the achievement of these outcomes. It is expected that many of these practices are already in place, but some new practices may have to be adopted. In certain areas, this may require changes to CLHIA Guidelines or provincial regulation where there may be need to shift industry practice or market structures in ways that will improve the industry's ability to achieve the FTC outcomes.

Once desired FTC outcomes are identified and practices have been identified, provincial and territorial regulators will likely expect regulated entities to embed changes in their processes to achieve the outcomes. Regulated entities that fail to implement these changes risk increased regulatory audits, reviews and recommendations and in some jurisdictions possible enforcement action resulting in orders, penalties or fines. It is likely that companies will have to report on their FTC programs as part of annual provincial/territorial regulatory reporting.

As noted above, Quebec's insurance legislation requires insurers to adhere to sound commercial practices including providing appropriate information, adoptinga policy for handling complaintsand resolving disputes, and keeping a register of complaints. The legislation gives the Quebec regulator the power to assess an administrative monetary penalty against companies that fail to adopt a complaint processing policy or keep a register of complaints.[14] Also, as noted above, Quebec in late 2021 launched a review of the SCP Guidance and is expected to reissue more detailed guidance.

This approach to implementing FTC is consistent with other aspects of the provincial and territorial regulatory framework governing life insurance. For example, regulators expect insurers to supervise contracted agents. This is expressed in Ontario where regulation requires the insurer to "establish and maintain a system that is reasonably designed to ensure that each agent complies with the Act, the regulations and the agents licence."[15] The FTC guidance and ongoing discussions evidence an expectation that in implementing FTC, insurers and

intermediaries will establish and maintain systems and business processes that are reasonably designed to promote the achievement of FTC outcomes for consumers.

In the future, FTC may provide a useful framework for examining how to adjust to innovation or market conduct that gives rise to regulatory concern. An emerging issue or concern could be examined to identify the consumer outcomes that would align with FTC, and the industry would be expected to adjust or adopt practices to ensure that insurers have business processes in place that are reasonably designed to promote FTC outcomes.

FTC AND THE LEGAL RELATIONSHIP BETWEEN INSURERS, INTERMEDIARIES AND CUSTOMERS

In Canada, the legal relationships between an insurer, an intermediary and a customer are established by contracts and the common (or civil) law. Insurance legislation may give customers certain rights or may override contractual provisions. Other statutes may give customers or intermediaries rights as well. Examples include provincial employment law in circumstances where the insurance agent is also an employee of the insurer, or provincial, territorial or federal human rights codes which may apply to insurer conduct or practices.

Insurers and customers owe certain duties to each other including the duty of utmost good faith, which includes a requirement for consumers to share information relevant to the risk being underwritten. Intermediaries in Canada have an obligation to avoid conflicts of interest and to deal fairly, honestly and in good faith with their customer (duty of care).[16]

Regulation, statute andlaws pertaining toemployees and agents result in life insurers having responsibility to oversee the conduct of intermediaries contracted to distribute their products and provide service to customers. Many intermediaries have contracts with multiple insurers and operate through one or more MGAs who, in arranging for the sale of insurance through their sub-agents also take on some day-to-day oversight of these agents. Insurers generally are only responsible for specific aspects of intermediary conduct. Most intermediaries are licenced insurance agents with their own regulatory requirements and are directly overseen by the provincial regulator or insurance council.

Customers have contractual rights that are enforceable in court and may also sue an insurer or intermediary for breach of a common law duty (such as in negligence) or the agent's duty of care. Statute and regulation may establish required terms for insurance contracts or deem that the parties have certain rights under an insurance contract.

It is reasonably well settled law in Canada that a statutory breach does not create a right of action or give rise to civil liability.[17] Provincial insurance statutes do not provide customers with a right of action where an insurer is in breach of supervisory guidance or a regulation. For example, a customer cannot sue an insurer for failure to properly obtain a licence or to implement compliance processes required by regulation. Only the provincial regulator can enforce these laws and regulations by seeking orders or penalties against a regulated entity.

The FTC Guidance is an articulation of regulator expectations about how regulated entities will conduct their business. Regulatory guidance cannot impact the nature of the legal relationship between insurer, intermediary and customer. The FTC Guidance does not form part of the legal duty of care which regulated entities owe their customers and does not grant customers a right of action founded in 'unfair treatment.' The FTC Guidance may inform a court's decision about the standard of reasonable conduct of an insurer or intermediary in a case of negligence but does not in and of itself create an enforceable right to be treated 'fairly.'

Quebec's insurance legislation has been amended to embed specific requirements related to FTC. The legislation does not grant a customer a right of action against an insurer or intermediary on the basis of 'unfair treatment.' The Quebec legislation gives the regulator the ability to sanction regulated entities

that are acting in ways that are inconsistent with the legislative provision.

Making a change to the legal duties owed by insurers, intermediaries and clients would require explicit legislation which would represent a significant realignment of the standard of care and a correspondent increase in potential legal liability for insurers and intermediaries. These types of fundamental changes cannot be implemented through regulatory guidance or supervisory practice.

A legislature examining changes to the duty of care would have to consider whether a standard of 'fair' is an appropriate or enforceable standard. The definition of fair in any given circumstance can be highly subjective and would not seem to provide much guidance to consumers or regulated entities about what is appropriate. The legislature would also have to consider the impact of such a vague standard on the potential liability and commercial viability of the regulated entities being held subject to such an uncertain standard.

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1 ICP 19 states: "The supervisor requires that insurers and intermediaries, in their conduct of insurance business, treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied."

2 http://www.g20.utoronto.ca/docs/g20history.pdf: "In September 1999, the finance ministers and central bank governors of the Group of Seven countries (the G-7) announced their intention to "broaden the dialogue on key economic and financial policy issues among systemically significant economies and promote co-operation to achieve stable and sustainable world economic growth that benefits all." This announcement marked the official birth of what subsequently became known as the Group of Twenty countries (the G-20). This new international group was launched primarily to address challenges to international financial stability posed by the widening crisis in emerging economies that had begun in Asia in 1997."

3 The G-20 created the Financial Stability Board (FSB) in 2009 by expanding the membership and mandate of the Financial Stability Forum. https://www.fsb.org/history-of-the-fsb/ The FSB helps coordinate global financial policymaking to promote financial stability.

4 https://www.fsb.org/about/leading-by-example/.

5 Whether the insurer is responsible for the conduct of the advisor is dependent on the facts including whether or not they were acting as the agent of the insurer or as an agent of the client and were acting in the scope of their authority.

6 https://lautorite.qc.ca/fileadmin/lautorite/reglementation/lignes-directrices-assurance/ligne-directrice-saines-pratiques-commerciales_an.pdf.

7 Interestingly at page 6 of the SCP Guideline, the AMF states that it expects the sound commercial practices principles to apply beyond interactions with clients to include "any other market participant with an interest in the institution (e.g., shareholders, partners, counterparties, market analysts and regulatory bodies)".

8 In October 2021, the AMF launched a consultation and issued a revised draft of the SCP Guidelines which may result in new guidance being issued in 2022 which is expected to build onto the existing guidance, expand the scope of the guidance and also provide more detailed expectations. The AMF has confirmed to the industry that it intends, to the extent possible, to harmonize the guidance adopted by other provincial regulators.

9 https://www.ccir-ccrra.org/Documents/View/3450.

10 The AMF's articulation of expected outcomes is similar to but not identical to the expectations later articulated by the CCIR. This paper is intended to explain the origins of the fair treatment of customers as a supervisory framework and the impact, if any, on the legal relationship between regulated entities and their customers or other market participants. In the interest of brevity and readability, this paper does not analyze the differences between the AMF SCP Guideline and the subsequent CCIR FTC Guidance or consider what

actual measures a company may want to implement to achieve the outcomes articulated by regulators.

[11] https://novascotia.ca/finance/site-finance/media/finance/insurance/Bulletin-2018-Fair-Treatment-of-Customers.pdf; https://www.bcfsa.ca/media/1240/download.

[12] http://legisquebec.gouv.qc.ca/en/ShowDoc/cs/A-32.1 see section 50.

[13] 3669 (ccir-ccrra.org).

[14] Ibid, section 429.

[15] Section 12 O. Reg. 347/04: AGENTS (ontario.ca).

[16] For a discussion of intermediary duty of care see https://www.advisor.ca/my-practice/conversations/duty-of-care/#:~:text=A%20duty%20of%20care%2C%20requiring,of%20the%20clients'%20securities%20transactions.

[17] *The Queen (Can.) v. Saskatchewan Wheat Pool*, [1983] 1 S.C.R. 205 where the Supreme Court held that the "civil consequences of breach of statute should be subsumed in the law of negligence and the notion of a nominate tort of statutory breach, giving a right to recovery merely on proof of breach and damages, should be rejected, as should the view that unexcused breach constitutes negligence *per se* giving rise to absolute liability. Proof of statutory breach, causative of damages, may be evidence of negligence and the statutory formulation of the duty may afford a specific, and useful, standard of reasonable conduct."