Canadian Life & Health Insurance Association
Association canadienne des compagnies d'assurances de personnes

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Robert Bradley
Chair
Canadian Council of Insurance Regulators

Eric Jacob
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Canadian Insurance Services Regulatory Organization

Sent by email to: ccir-ccrra@fsrao.ca

Dear Robert and Eric,

On behalf of the Canadian life and health insurance industry, I am pleased to provide the industry's feedback on the Canadian Council of Insurance Regulators (CCIR) and Canadian Insurance Services Regulatory Organization (CISRO) consultation regarding upfront commissions. A key takeaway from our submission is that the insurance industry strongly supports the important role played by the advisor chargeback sales charge option.

Our submission is organized as follows:

- The industry's high-level views on key issues;
- A more fulsome explanation and support for the industry's views are included as Appendix A; and
- The industry's responses to the CCIR and CISRO's questions from the consultation paper are set out in Appendix B.

About CLHIA

The Canadian Life and Health Insurance Association (CLHIA) is a voluntary association with member companies that account for 99 percent of Canada's life and health insurance business. These insurers are significant contributors to Canada and its economy. In 2021, they provided financial security to over 29 million Canadians and made over $110 billion in benefit payments (of which 90 percent went to living policyholders as annuity, disability, supplementary health, or other benefits with the remaining 10 percent going to life insurance beneficiaries). In addition, life and health insurers have nearly $1.1 trillion invested in Canada's economy. In total, 92 life and health insurance providers are licensed to operate in Canada.

Overview of Key Issues and the Industry's Views

The current system, including the advisor chargeback sales charge option, works well and helps a broad range of consumers achieve financial security. Any contemplated changes should be carefully considered to ensure there is improved service provided to consumers and unintended harms to consumers do not result. We strongly support the continued use of advisor chargebacks to ensure Canadians continue to have access to segregated fund products and advice more generally.

The industry's key reasons for supporting the continued use of advisor chargebacks are as follows:

a. Segregated funds and mutual funds are complementary within an investor's portfolio (not substitutes): Segregated funds are often part of a comprehensive financial plan and complement mutual funds due to their long-term nature and unique protection and financial planning benefits. Therefore, differences in how they are regulated should be supported.

b. Advice is more important to accessing segregated funds than mutual funds: Segregated funds provide unique tax, creditor, and estate planning optimization strategies to consumers. These features can be complex and are not well known to the general population, which makes access to professional financial advice more important when investing in segregated funds than mutual funds.

c. Access to advice will be lost for the majority: We estimate segregated funds accounts at $50,000 and below are at serious risk of being uneconomic for advisors to serve in a trailer commission-only sales charge option. These account sizes represent approximately half of all segregated funds investors.

d. Fee-for-service sales charge option is not well suited to segregated funds: Managing General Agents (MGAs) do not have the same Self Regulatory Organization (SRO) oversight or expectations as securities dealers do. This means that sales charge options are generally managed with each separate insurer through client name accounts.

e. Risk of conflict of interest is low with segregated funds: The average hold time for segregated funds is nearly 8 years. As such, it is not common that advisors have to return commissions. In addition, chargebacks are at the account level for segregated funds so fund holdings can be switched within an account without incurring chargebacks.

f. Chargebacks are consistent with CCIR guidance: Commission recovery from the advisor disincentivizes churning. The CCIR's draft incentive management guidance expects insurers and intermediaries to provide arrangements for recovering the commission to minimize this risk.

The industry recognizes that regulators have concerns with certain aspects of chargebacks, such as the potential for conflicts of interest. As set out in our submission, there are approaches that could manage these risks effectively while also allowing chargebacks to be maintained. This could include establishing a chargeback period with a three-year cap on the length of chargeback schedules. This would be the most balanced approach going forward as it would improve the current system, which works well and helps ensure a broad range of consumers continue to have access to the advice and product that they need to achieve financial security, while addressing regulatory concerns.

We look forward to further collaboration with regulators on how improvements can be made while maintaining chargebacks with a view to benefitting consumers.

Yours sincerely,

Stephen Frank

APPENDIX A – THE IMPORTANCE OF RETAINING CHARGEBACKS

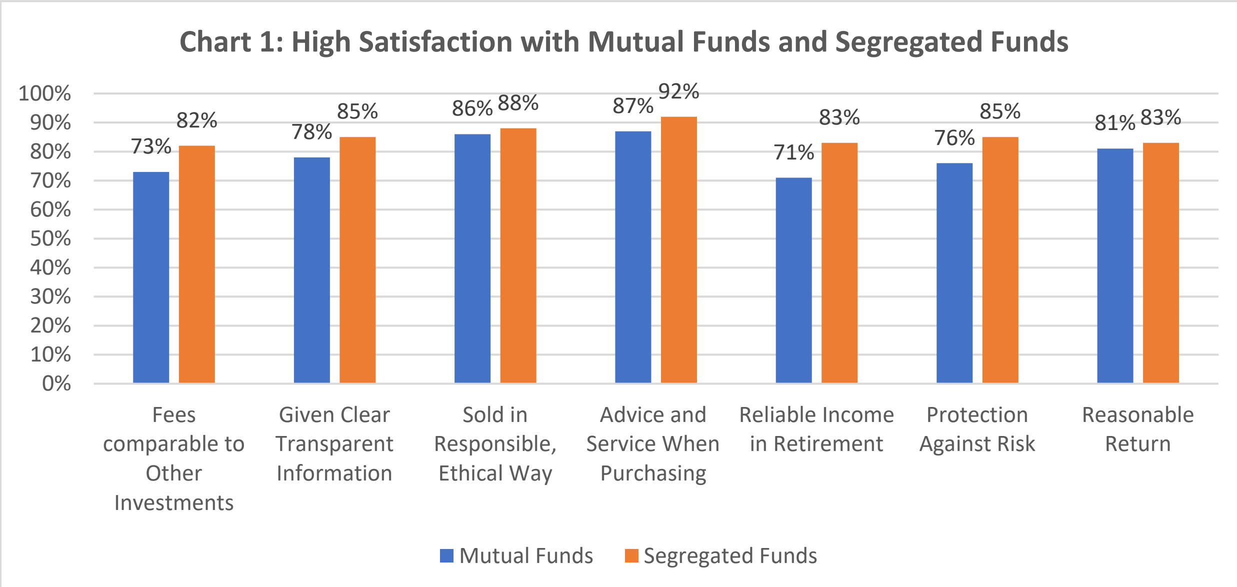
SEGREGATED FUNDS AND THE MARKET WORK WELL FOR CONSUMERS

Market research was recently conducted by Abacus to obtain views from users of segregated funds and mutual funds to determine how well the market is serving consumers.[1] The key findings from the research are as follows:

- Satisfaction levels with both products are high, with the satisfaction level being higher for segregated funds than mutual funds. Specifically, more than 80 percent of consumers are satisfied with segregated funds when it comes to reliable retirement income, protection against risk, and reasonable returns.
- Of the Canadians that have used segregated funds, 77 percent purchased these products from an insurance broker whereas those who have used mutual funds have mostly purchased them from a financial advisor (58 percent) or a bank broker (38 percent). This demonstrates a higher need for advice in the purchase of segregated funds.
- When it comes to advice and service consumers received from an insurance broker when purchasing segregated funds, satisfaction levels are high – with 92 percent being satisfied.
- In terms of the fees associated with segregated funds, 82 percent of consumers who have used segregated funds are satisfied that the "fees are comparable to other investments", whereas 73 percent held the same view for mutual funds.
- 85 percent of consumers are satisfied buyers are "given clear and transparent information" when they are sold segregated funds, compared to 78 percent for mutual funds.
- 88 percent of those with experience with segregated funds are satisfied they are "sold in an ethical and responsible way".

[1] In total, 709 people who had experience with segregated funds and 782 who had experience with mutual Funds were interviewed between September 4 and October 3, 2022.

Chart 1, below, illustrates the high degree of satisfaction with the current market for segregated funds and mutual funds.



This market research demonstrates that segregated funds are serving consumers well in the current environment. Furthermore, the results are consistent across different demographics including regional, generational, and socio-economic.

WHY SEGREGATED FUNDS HAVE CHARGEBACKS IF MUTUAL FUNDS DO NOT

With the context of a segregated fund market that currently serves consumers well, we now turn to examine a number of important issues related to both segregated funds and mutual funds. This includes, for example, the role each plays, how they are different, the role of advice and potential conflicts of interest.

a. How segregated funds are different from mutual funds

Regulators are concerned about keeping the regulatory regimes for segregated funds and mutual funds as harmonized as practical to avoid the possibility of regulatory arbitrage. This is a worthy objective that we generally support. However, we would note that there is no evidence of regulatory arbitrage in the current environment.[2]

[2] See the November 2, 2022, Investment Executive article "What caused soaring seg fund sales last year", where Investor Economics confirm that the increase in sales was not due to regulatory arbitrage. Market performance and a focus on estate planning were key reasons for a rise in seg fund sales. "Overall on-book segregated fund assets among independent financial advisor dealers (largely MFDA) dropped about 10% in 2020 and were relatively flat in 2021," https://www.investmentexecutive.com/news/industry-news/what-caused-soaring-seg-fund-sales-last-year/

There are substantial differences between mutual funds and segregated funds that merit different treatment related to retention of the advisor chargeback model. Indeed, the regulatory framework should recognize that there are positive consumer outcomes associated with mass market distribution of segregated fund products.

i. The role of segregated funds and mutual funds

Segregated funds are a wealth preservation, protection and growth product. Conversely, mutual funds are primarily a growth product. Segregated funds are often purchased as one component of a comprehensive financial plan. For example, segregated funds are often purchased in addition to mutual funds, rather than instead of mutual funds (i.e., they are complimentary, not substitutes). Segregated funds are used more as an estate planning tool than mutual funds since they combine the growth potential of mutual funds with principal protection for peace of mind.

The benefits under segregated funds can be paid to beneficiaries or assigned to a successor owner both inside and outside registered accounts. This is an effective estate planning benefit of segregated funds as it helps keep assets from getting held up in the estate administration process and avoids probate fees. Mutual fund holders can only appoint beneficiaries in registered accounts.

As life insurance products, segregated funds with a named beneficiary can also offer potential creditor protection. As well, segregated funds can guarantee an immediate income stream in retirement for a fixed period or for life. Features such as these are unique to segregated funds.

The Abacus market research provides further evidence of the benefits of segregated funds to consumers. In particular, the research found that the most important aspects to consumers are:

- Reasonable return (89 percent)[3],
- Reliable income in retirement (87 percent),
- Protection against risk (85 percent),
- Creditor protection (84 percent), and
- Estate planning features (80 percent).

[3] The percentages identified represent responses that indicated “highest” or “important”.

ii. How the use of segregated funds and mutual funds differ

Segregated funds are by their nature a long-term investment product. In many cases, the benefits of segregated funds (such as the guarantees and the funds that guarantee income in retirement) cannot be realised until retirement or death.

The long-term nature of segregated fund investments is evidenced by 80 percent of segregated funds contracts being in registered accounts. Conversely, only 62 percent of mutual fund units are in registered accounts. In addition, the Abacus market research adds further support that consumers recognize segregated funds as being a long-term investment with 83 percent holding this view.

The average time segregated funds investors stay invested is also higher than for mutual funds. The average hold time of a segregated fund is nearly eight years, whereas in 2019 the average equity mutual fund investor stayed invested for 4.5 years.[4] The chargeback function recognises the long-term nature of segregated funds.

In addition to those looking for retirement savings and income, segregated funds are typically marketed to the following types of customers with protection objectives:

- Customers saving for retirement who are looking for the benefits offered by segregated funds including risk capital protection and life insurance features with capital growth potential,
- Customers seeking capital risk protection for their estate and the opportunity to name beneficiaries,
- Customers saving for a first house who want growth potential and need capital protection,
- Customers saving for a child's education through an RESP and need downside protection,
- Customers who are close to retirement and want to protect against market volatility, and
- Small business owners or professionals looking for potential creditor protection.

b. Segregated funds are an insurance product

Segregated funds are an insurance product accessed through an insurance advisor. Segregated fund compensation structures should therefore be considered differently than mutual funds. Customers may be content to pay under the fee-for-service sales charge option for mutual fund dealers but this does not mean this option will be viable for insurance advisors and MGAs.

Chargebacks were created by the insurance industry to recognize the long-term nature of insurance products. If an insurance policy lapses, the advisor risks having to pay back the sales commission. This incents an advisor to only sell products which are suitable and meet the clients needs by encouraging the advisor to plan for the client's future rather than a short-term sale and commission.

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[4] Quantitative Analysis of Investor Behavior, 2020 BALBAR, Inc. www.dalbar.com

Chargebacks have not been used for mutual funds which, as noted above, are generally shorter-term investments compared to segregated funds.

Point of sale disclosures make customers aware of the different sales charge options available that provide them with the choice of how their advisor is compensated. Further, point of sale disclosures make customers aware that an early withdrawal could result in their advisor having to return all or part of their commission. We are therefore confident that customers dealing with life insurance agents commonly understand that their advisor is paid an upfront commission and are aware of the chargeback function.

c. Dealer fee-based accounts work well within a nominee name structure but not an MGA model

The ban on up-front commissions for securities dealers resulted in a transition from advisory fees embedded in the Management Expense Ratio (MER) to directly charged fees in dealer fee-based accounts.

Nominee accounts allow intermediaries to group their clients' assets held at different manufacturers, thereby allowing a singular fee to be levied by the intermediary. Conversely, separate client name accounts are set up with each insurer a client may hold assets at, meaning that a separate fee must be levied to each account.

Since a different compliance and regulatory structure applies to dealers vs. MGAs (i.e., MGAs do not have the same SRO oversight or expectations as securities dealers do) sales charge options are generally managed by MGAs with each separate insurer through client name accounts.

Fee-based segregated fund sales charge options administered by the insurer have been introduced in this client name model but have not gained traction due to challenges and complexity with this structure. Moreover, the *Income Tax Act* does not allow the customer to deduct fees on their tax return for segregated fund investment advice, but it does allow it for securities, which makes a separately charged advisory fee option much less attractive for segregated funds.

d. Advice is more important to accessing segregated funds than it is for mutual funds

Receiving advice on the purchase of segregated funds is critical to customers. This reflects that segregated funds are complex products. Advice ensures the customer understands the unique benefits they offer and ensures they are suited to the customer's circumstances. This is less applicable to mutual funds.

There are unique tax, creditor, and estate planning optimization strategies available through investment in individual variable insurance contracts and segregated fund investments. Since these features can be complex and are not well known to the general population, access to professional financial advice is more important when investing in segregated funds than other financial products like mutual funds and exchange traded funds (ETFs).

Independent distribution, as opposed to exclusive sales forces, accounts for 75 percent of all segregated fund assets under management. When life insurance advisors and MGAs are independent, insurers compete on the features and price of the range of their products which ultimately benefits consumers. Independent distributors rely on upfront commissions to cover their costs of doing business. Without upfront commissions, independent distribution channels are at risk of being non-economic.

Many consumers would lose access to a competitive independent distribution market without upfront commissions and the chargeback option. This is especially true for smaller accounts, which would not be economical for advisors to service on a trailer-only commission.

To illustrate this point, data collected by Investor Economics in 2015 shows that the average recurring annual business expense to an advisor and/or MGA per client is between $750 and $1,000, which is a conservative estimate as it does not account for the greater “start-up” or “onboarding” costs during the first year. Further, it does not account for the increase in administration costs that will result after the client-focused reforms and CCIR’s planned Market Conduct Guidance for Segregated Funds.

CLHIA has collected data from its members and conservatively estimates segregated accounts at $50,000 and below are at serious risk of being uneconomic for advisors to serve in a trailer commission only (Front End Load (FEL) Zero or No-load) model.[5] Currently, approximately half of segregated funds investors, have less than $50,000 as their account/ policy value, which would equate to over 1. 5 million Canadians.

A ban on chargebacks, therefore, has the real potential for significant consumer harm.

Experiences in the UK and Australia with removal of upfront commissions suggest that there is a real risk of loss of advice in the mass market.[6]

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[5] Under current upfront commissions sales charge options, an initial deposit of $25,000 could pay an advisor and/or MGA $750 in the first year and $250 thereafter. On an initial deposit of $75,000, an advisor and/or MGA might make $2,250 in upfront commission and $750 in subsequent years. Please note that charge-back structures vary across the industry. This example is for illustration purposes only.

[6] The December 2020 report of the U.K. Financial Conduct Authority entitled “Evaluation of the Impact of the Retail Distribution Review and Financial Advice Market Review" (see page 13) found that people with lower investable assets are simply ignored and not approached by advisors, even those at banks. "One potential barrier mentioned in our qualitative research was that consumers are not always encouraged to seek it. For example, some explained that, in the past, they were prompted to engage with their finances during visits to bank branches, when bank staff would encourage them to seek support for financial planning questions." Up to 8.4 million people with more than £10,000 in investible assets do not currently seek formal support from which they could potentially benefit by helping them make financial decisions. 2020 Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review (fca.org.uk)

e. Aligning compensation to the cost of providing the service

“Start-up” or “onboarding” costs mean that the cost of providing advisor and MGA services to clients is higher in the initial years and then decreases. The way advisors and MGAs are compensated should recognise this and allow for cost recovery immediately rather than having to wait multiple years to receive a profit.

Advisor chargeback options and upfront commissions mean that advisors can at least cover the cost of providing the service initially. The advisor chargeback does not change the cost to the client or investment performance over the expected life of the contract. There is no difference in the cost to the client between the advisor chargeback and FEL-0 options.

f. Chargebacks can protect customers

The industry agrees that in the context of reviewing upfront compensation for segregated funds the key outcome should be the fair treatment of customers. We believe that the advisor chargeback sales charge option is not in conflict with FTC objectives.

We would note that the CCIR draft Incentive Management Guidance in section 2.8 states that the design and management of incentive arrangements should include recovery of compensation, where appropriate, once it has been paid. We believe it is appropriate to recover commissions in situations where the sale was not appropriate.

In addition, chargebacks are a well-established structure in the insurance industry. As noted, segregated funds are intended to be a long-term investment product and they are viewed that way by consumers. Consistent with this, the chargeback function encourages advisors to recommend a suitable long-term financial roadmap. This includes the advisor thinking about the long-term objectives of the consumer.

Commission recovery from the advisor also disincentivizes churning since advisors would need to repay the commission from the initial purchase before collecting a commission from the next investment. An advisor having to pay back a commission to an insurer may indicate the sale was not suitable in the first place (a change in life circumstances could also be a factor). If customers do not have any liquid assets to use in emergencies, then segregated funds are generally not a suitable product.

It is important to note that advisors having to return commissions is not common. This reflects that the average hold time of a segregated fund is nearly eight years, and the average chargeback period is between two and five years. This indicates that chargebacks are not generally being paid by advisors.

g. Are advisors conflicted under the chargeback option?

The concern has been raised about whether an advisor would ever recommend a redemption during the chargeback period.

Segregated funds are not as susceptible to market forces in comparison to mutual funds due to the guarantees on segregated funds. In most circumstances, it will be in the customer's best interest to stay invested in the segregated funds despite market fluctuations due to the guarantees.

In addition, holdings can be optimized within the contract since switches are allowed within a contract. This means advisors can move their clients to a different fund manager, to lower risk or higher risk investments, as appropriate, without incurring chargebacks.

Furthermore, since the chargeback is at the contract level rather than the fund level there is no commission incentive for advisors to select one fund over another.

Looking at the data collected by the CLHIA, there is also no evidence of shorter or longer hold times for segregated funds sold under the chargeback option and when compared to other load types (i.e., Front-End-Load). This indicates that the chargeback does not incentivize advisors to keep clients invested longer than they should.

Ultimately, any concern of conflicted advice can be mitigated by monitoring redemptions after the chargeback period expires.

Any potential conflict can be managed by the requirement for disclosure by an intermediary that a chargeback will apply and documentation of the reasons for a recommendation. This is addressed in the CCIR's planned Market Conduct Guidance for Segregated Funds.

A robust regulatory framework currently exists for the management of conflicts of interest.

APPENDIX B: INDUSTRY RESPONSES TO CONSULTATION PAPER QUESTIONS

1. Please comment on whether the topics and details covered in this discussion paper accurately describe the current environment in which Customers are offered IVICs and segregated funds and provide any necessary factual corrections or additional information.
Generally, the Consultation Paper is accurate in describing the current environment in which customers are offered Individual Variable Insurance Contracts (IVICs) and segregated funds. At page 9, under the heading 'Potential Customer Harms' the Consultation Paper notes that 'Varying lower trailing commission rates may also create a risk of unserved Customers ("orphan clients"), where the trailing commission rate is so low as to disincentivize a new Intermediary to take over the servicing of Customer's IVIC.' However, today almost all trailing commissions revert to the highest trailing commissions available after the end of the chargeback period. (i.e., that is usually to the trailer offered under low-load or FEL Zero). As such, there is no general disincentive for an advisor to service orphan clients. At page 9 under the heading 'Potential Customer Harms' the Consultation Paper states that upfront commissions may incentivize an intermediary to sell an IVIC even when a customer does not need an IVIC. We would note that sale of an IVIC should be based on a customer's needs. From a consumer perspective there is no conflict if they have been sold a suitable product which meets their needs. An intermediary should not be required to make the sale in context of a comparison with a mutual fund strategy. Evaluation should not extend beyond the general requirement for the product to be suitable. However, any potential for conflict can be addressed by the requirement for a reason why letter setting out why the segregated fund is recommended. Also at page 9, under the heading 'Potential Customer Harms' the Consultation Paper notes that commission rates may vary to as high as 7 percent. We would note that the 7 percent upfront commission rate is a temporary promotional rate offered by one insurer and does not incur any additional cost to the consumer. The current maximum rate in the industry on the advisor chargeback sales charge option is 5.6 percent. The paper states on page 8 that outside of Fund Facts and Information Folders, IVIC customers presently receive minimal ongoing disclosure about intermediary compensation costs. We note that when the TCR is implemented customers will receive comprehensive information about the costs they are paying. We understand that CCIR is proposing that there should not be a break-out of distribution costs as part of total cost reporting (TCR) and that consumers are best served by reporting a total cost figure. Customers are aware of the percentage commission their intermediary receives based on the sales charge option they select with their intermediary at the time of sale.

To ensure that customers are aware that a chargeback may apply, where applicable, the insurance industry suggests including a flag on the annual statement to give the customer a heads up that an advisor commission chargeback may apply upon a fund unit redemption.

2. Should Insurance Regulators consider other Targeted Customer Outcomes?

We agree with the identified customer outcomes. However, we would note that the objectives describe circumstances that are not common problems in the market.

Additional important customer outcomes are:

- Providing consumers with long-term financial security.
- Ensuring segregated fund products are available to the mass market.
- Paying segregated fund proceeds to named beneficiaries.
- Assisting consumers with saving for retirement, education or buying a house.
- Providing protection against market volatility in the circumstances of unexpected death.

As the Abacus market research demonstrates, these are objectives that are important to consumers and are being met under the current market. It is important that any contemplated changes would not negatively affect the ability for these outcomes to be achieved.

3. For each Sales Charge Option in Appendix 1,

a. How prevalent is the Sales Charge Option?

The CLHIA conducted a survey of members this past spring requesting information about the current mix of sales charge options being used. The information collected for 2021 is set out in the table below.

2021

Commission type	AUM	Sales value
Front-end Load	24%	36%
Deferred Sales Charge	46%	18%
Low-Load	6%	4%
No-Load (Excl. Charge-back)	10%	10%
Charge-Back	14%	31%
F-Class/Fee-Based	0%	1%

The CCIR should be aware of the following observations:

- There is almost no FEL with a negotiated fee. Almost all of the FEL sales are FEL-0.
- The industry tracks FEL-0 under FEL, whereas the CCIR has included FEL-0 under No-load.
- FEL-0 is the most common sales charge. However, it is often not an economical model for individual, independent advisors, smaller MGAs and new entrants, who are providing

service to the mass market or younger people with less assets and may need structures that better align the timing of compensation with the timing of the work being done by the advisor.

- Historically, advisor chargeback was categorized as being part of No-load and used predominantly by one insurer so there is no separate categorization before 2020. Please see note 5 below.

The following are statistics for the previous three years to help give context to the 2021-year information.

Recent sales by sales charge options

Sales charge type	2018	2019	2020[7]
FEL	38%	37%	34%
DSC	30%	26%	22%
Low Load	8%	5%	5%
No Load (incl. Charge-back)[8]	20%	27%	36%
Fee-Based	4%	5%	3%

b. Where a Sales Charge Option has a range of possible compensation rates, such as Front-End Load, how do Insurers or Intermediaries determine the amount to charge a Customer? Are there common rates charged?

Where there are a range of sales charge options offered under an IVIC, the consumer and intermediary agree together about which is the best sales charge option to pick. Where there is a range of compensation rates such as for FEL, the advisor and consumer would agree together on the fair rate to be charged. However, please note that the FEL option which allows for investment minus a negotiated upfront fee is not generally being used. The reason being the same for why fee-based accounts have not gained a lot of traction; there are challenges with distribution structures. Generally speaking, independent advisors and MGAs do not have system capability to accommodate processing fees for each client. There is an insufficient regulatory structure for MGAs.

Due to the range of distribution practices in the insurance wealth space, there is a range of different compensation structures. This allows for broad access to insurance wealth by all segments of the Canadian population. For example, National Accounts which are large, sophisticated enterprises that also sell mutual funds, can facilitate flat fee structures due to their sophisticated structures, whereas, independent advisors and smaller MGAs do not have the

[7] 2020 data represents data collected from CLHIA members up until June 30, 2020.
[8] The amount of Charge-back in 2020 was 21 percent of 2020 total gross sales, meaning No Load was 15 percent. There has been a significant increase in advisor Charge-back in recent years. The amount of advisor Charge-back prior to 2020 cannot be separately disclosed at an industry level from the No Load option since prior to 2020 categorization of the Charge-back sales option was not consistent across the industry.

accounting capacity to maintain fee accounts for all their customers. It is more common for these independent advisors and smaller MGAs, who typically provide service to customers with less investable assets, to utilize the charge-back option.

Some insurers however allow for a separate advisory fee (F-Class/Fee-Based) to be charged and paid monthly by redemption of units. The consumer and intermediary agree to the rate to be charged. Higher percentage rates generally apply for small-value contract situations and range for larger contracts. As explained above, it is the insurer not the MGA or advisor who deals with the accounting aspects of this kind of structure.

Reduced management fees can also apply for high-net worth contracts starting at $250,000 or up. For ultra-high net worth clients, further reduced advisory fees may be agreed to.

c. Please describe in detail how current Insurer and Intermediary processes and controls align with Targeted Customer Outcomes, including, but not limited to, outcomes 1 to 3. Are there different processes and controls for different Sales Charge Options, such as between the Advisor Chargeback and Front-End Load options?

Advisor processes and controls

As part of the initial sale, the intermediary meets with the client and explains the different sales charge options that are available and how the intermediary will be compensated. This includes a discussion of the features of each option. Details of the advisor chargeback option would be explained to a consumer including disclosure of the possibility that the advisor may have to return the commission.

Advisors have statutory obligations to avoid conflicts of interest and operate in compliance with this framework. (See discussion related to conflicts of interest above)

Plain language disclosure of the sales charge options is provided on Fund Facts.

A large amount of time is needed to review the needs of a client and explain an IVIC including the insurance and investment features. The upfront commissions offered in the advisor chargeback sales option reflect this requirement and act to fairly compensate for the time and effort needed.

The chargeback option provides an annual trailer fee payment to the advisor for ongoing service. Similarly, all of the other sales charge options provide compensation for ongoing service to the contract holder which provides an incentive for the intermediary to provide ongoing service to the client.

From the customers perspective, the advisor chargeback option gives customers control over ongoing service as advisors are incentivized to ensure their customers are satisfied with their level of service to avoid incurring any chargeback penalties. In the scenario that a customer is unsatisfied with their advisor (which we see from the Abacus data is rare) customers can withdraw their funds and move to a different advisor. The risk that advisors would unduly influence their customers to stay invested in segregated funds that are not in their best interest is very minor since a customer who is not satisfied with their advisor can withdraw funds directly with the insurer and does not need to contact their advisor.

Insurer Processes and Controls

Insurers adopt a risk-based approach to compliance monitoring. If any unusual practices or patterns of conduct related to an intermediary are identified, these would be investigated. Requests for investment which do not fit within the standard parameters of a product would be individually reviewed.

Similarly, insurers monitor for persistency to ensure that customers are not moved into a new product at the end of the chargeback period. This could suggest that the advisor is churning, or that the customer was influenced to stay in a fund until the chargeback period has ended.

Insurers also monitor for switches between sales charge options during the chargeback period that could indicate an advisor is trying to take advantage of a renewed or higher commission option.

d. Please describe how Insurers and Intermediaries can encourage innovation and flexibility in ways Customers can pay for advice.

Consumers are best served by having a broad range of options in the market. Regulatory action should not limit this choice by placing undue restrictions on the compensation models available in the independent distribution system. A free market will allow insurers and intermediaries to foster innovation and result in a broader range of financial services being made available to consumers. Too many regulatory restrictions will limit choice.

Consumers need to be encouraged to save and invest and benefit from receiving advice from an intermediary. It is crucial that the provision of advice remains economically viable.

The advisor chargeback is an innovative model that insurers have developed. It has the advantage of providing upfront compensation to intermediaries, of providing customers equivalent or better investment performance than other sales charge options, and consumers are not required to pay a fee when they sell units.

4. Please comment on the extent to which Insurers and Intermediaries provide payments or benefits for the sale of segregated funds or IVICs other than the commission rates set out in Information Folders and Fund Facts and how the payments or benefits align with the Targeted Customer Outcomes, including, but not limited to, outcomes 1 to 3.
The commission payments described in the information folder and fund facts constitute all of the compensation that an advisor receives for the sale of segregated fund products. Insurers do provide production and persistency bonus payments based on the volume of sales of traditional life insurance products. For captively contracted life insurance agents, segregated fund sales may be included when considering the total volume of sales for purposes of qualification for bonuses. However, there is no distinction made based on the sales charge option choice. There is therefore no advantage or conflict created in choosing front-end load versus advisor chargeback. Segregated funds provide a low commission rate relative to traditional life insurance products and the market is highly competitive. Insurers support the principal that incentives should align with the fair treatment of customers. Insurers support a risk-based approach to incentives management. In the absence of a risk-based approach, insurers would lose the ability to focus attention and resources where the greatest benefit could be achieved.
5. If Insurance Regulators were to implement a regulatory ban on Upfront Commission or Upfront Compensation, what would be the insurance sector considerations to take into account for achieving the Targeted Customer Outcomes? Where possible, please provide data to support your position.
There are many negative outcomes that could result from a decision to implement a regulatory ban on upfront commissions. The main risk is loss of access to advice in the mass market. As mentioned, we estimate segregated accounts at $50,000 and below are at serious risk of being uneconomic for advisors to serve in a trailer commission-only sales charge option, which is approximately half of segregated funds investors.[9]

[9] For example, under the current upfront commissions sales charge options, an initial deposit of $25,000 would advance an advisor and/or MGA $750 in the first year (3%) and $250(1%) in each year after the end of the chargeback period. On an initial deposit of $75,000, an advisor and/or MGA might receive $2,250 (3%) in upfront commission and $750 (1%) in subsequent years after the end of the chargeback period. On a trailer commission- only sales charge model, the same advisor would receive only $250 in the first year and subsequent years on a $25,000 deposit, and $750 in the first year and subsequent years on a $75,000 deposit. Charge-back structures vary across the industry, and this is an illustrative example only. Generally, there is a reduced trailer fee paid during the chargeback period. The trailer fee becomes level after the end of the chargeback period. Total compensation is generally similar to other sales charge options. There is no difference in cost to the client.

We would also note that the loss of advice has been observed in the securities industry with the move away from DSC sales which caused consolidation and a reduction in the number of advisors. The MFDA Client Research Report 2020 notes that the number of advisors licensed by Financial Advisory firms decreased by 5,681 or 17% from 2016 to 2019. The majority of these advisors had books of less than $10 million. This decrease is largely a result of MFDA prohibiting the sale of DSC funds which small book advisors rely on to finance their operations. Insurers may also provide compensation to MGAs based on the volume of business the MGA does with an insurer. The insurance sector requires clarity from regulators that they are only consulting on a regulatory ban on upfront commissions paid to advisors in connection with the sale of segregated funds. Any broader scope would have profound negative impacts on the industry, since the compensation paid to MGAs is based on all insurance products the MGA distributes through its advisors. A regulatory ban on upfront compensation paid to MGAs in connection with segregated funds might result in a preference for advisors to sell products that do not have upfront compensation banned, thereby creating the potential for conflict, rather than reducing it.
a. How could any ban for segregated funds be worded to achieve the Target Customer Outcomes?
The targeted customer outcomes can be best achieved by establishing best practices on the use of the advisor chargeback sales charge option. Possible restrictions are discussed in our response to question 6 below. The potential for a conflict is created when there is a need for withdrawal of funds earlier than expected. The advisor chargeback should not exceed the time horizon for investment. Any conflict of interest will be eliminated if the time horizon for investment is longer than the chargeback period. A minimum 10 percent free withdrawal amount should be standardized for all contracts. This will generally level the playing field between an intermediary and a consumer seeking access to funds by removing a commission charge to the intermediary where a portion of the funds are withdrawn. A chargeback should also not apply for RRIF withdrawals in accordance with the statutory minimum withdrawal rate ranges. This will give consumers access to their invested funds in retirement without creating a conflict for the intermediary.

b. What would be the minimum transition time needed to implement an applicable ban and arrange for the use of different compensation and fee structures?
Adapting to changes will not be easy. The insurance industry has been reliant on an independent distribution framework. A major change to the commission approach (no more upfront commissions) needs to be considered in context of the overall regulatory framework for distribution and sale of segregated funds. The switch to using a directly charged fee model in the securities industry has been supported by the robust regulatory framework for Mutual Funds Dealers Association (MFDA) and Investment Industry Regulatory Organization of Canada (IIROC) dealers, which does not currently exist for MGAs. Many system changes are needed to support a different sales charge option. While many companies offer several different sales charge options, not all companies do. A transition period of several years is needed to make required system adjustments and restructure compensation.
c. What are the estimated qualitative and quantitative costs and benefits of a ban to Insurers and Intermediaries?
It is difficult to separate the qualitative and quantitative costs and benefits of a ban. Insurers will potentially lose access to new sales in the mass market. The potential quantitative impact of a ban on advisor chargeback is that sales in the mass market will not be economic. The CLHIA calculates that there are approximately three million segregated fund policyholders. Half of these have contracts that are $50,000 or less. Approximately 31 percent are sold using advisor chargeback. When the change related to DSC and a change related to advisor chargeback are considered together, this represents approximately 50 percent of sales. The possible impact is that there will not be new sales to the mass market. Customers with under $100,000 to invest will not be served by independent advisors and will require to seek investment assistance by a bank advisor. Advisors will need to adjust their target market and sales approach to have a model which is economically viable. The potential qualitative impacts are that there is not an economic model for new advisors starting out. This could result in fewer young intermediaries entering the market, where the average age of an insurance intermediary is currently over 50 years old.

d. What are the estimated qualitative and quantitative costs and benefits of a ban to Customers?

Consumers will likely have less access to advice.

Consumers will likely have less access to the unique insurance features that segregated funds offer.

Consumers will likely have less savings and less long-term financial security.

Many consumers are motivated by a “financial coach” to establish a plan for a secure financial future and there will be fewer consumers being encouraged to save.

6. If Insurance Regulators were to implement alternative or complementary regulatory measures to a ban, which regulatory measures would help achieve the Targeted Customer Outcomes? Throughout Insurance Regulators’ discussions with industry, the following measures were proposed as examples to foster stakeholders reflections on this matter:
• a cap on amount of Upfront Commission,
• limits on the duration of chargeback schedules,
• increased monitoring of Licensed Individuals with chargeback debt,
• enhancing disclosure of potential costs or negative effects to the Customer of available Sales Charge Options, and
• requiring Upfront Compensation paid to Intermediaries be reasonably proportionate to value of the product and amount of service provided to the Customer.

Our industry has a strong history of working with regulators to develop measures to enhance customer outcomes.

The industry is willing to meet with regulators to discuss the customer protection measures mentioned above that would support the Targeted Customer Outcomes.

In addition to the above, other consumer protection measures could include, for example, capping the chargeback period with a three-year cap on the duration of chargeback schedules.

Please provide supporting evidence in your response to explain:
a. where such measures differ from the regulatory approach taken by the CSA, why such an approach would be reasonable for segregated funds even if the approach is not permitted for mutual funds?
Advisor chargeback is a sales charge option being used for segregated funds. It is an insurance developed approach that has a long history of successful use and which has been more widely adopted by insurers in the last few years. Since it was not in general use on the mutual fund side, different considerations apply in determining whether to no longer allow it. We have provided detailed reasons above why segregated funds should be considered a different product than mutual funds.
b. how such an approach aligns with Targeted Customer Outcomes?
The shortened period for the chargeback which we are proposing reduces the possibility for conflict of interest. If segregated funds are withdrawn within a short period of time, in many circumstances it raises the question about suitability of the original sale. The longer segregated funds are held, the more likely it is that a change will be driven by a change in the consumer's circumstances. The industry is willing to meet with regulators to discuss the customer protection measures mentioned above that would support the Targeted Customer Outcomes.
c. the estimated qualitative and quantitative costs and benefits of the applicable alternative regulatory measures to Insurers and Intermediaries?
Under our proposed compromise approach, intermediaries are likely to receive less upfront commission and more trailing commission. This will reduce the upfront income for new intermediaries in the short term. The compromise is intended to provide a balance to reduce the potential for conflict, while providing fair compensation for the work involved with a segregated fund sale. Intermediaries will need to adjust their business model with a new approach to compensation.
d. the estimated qualitative and quantitative costs and benefits of the applicable alternative regulatory measures to Customers?
As detailed at length above, it is possible that consumers in the mass market will receive less upfront service with reduced incentive to intermediaries.

e. the minimum transition time needed to implement such regulatory measures?
Adjustments will be needed to systems, however, changes to the compensation parameters for advisor chargeback could be implemented fairly quickly. As with all changes, a 1–2-year implementation period is needed.