PARAGRAPH 7.1 - DISCLOSURE OF FACTS INDICATING POTENTIAL CONFLICTS OF INTEREST

14.7.1 A MEMBER SHALL DISCLOSE IN WRITING TO A CLIENT OR PROSPECTIVE CLIENT ANY CONFLICT OF INTEREST OR POTIENTIAL CONFLICT OF INTEREST OF THE MEMBER THAT IS ASSOCIATED WITH A TRANSACTION OR RECOMMENDATION.

COMMENTARY:

Background

The disclosure requirements in this paragraph replace both the majority share ownership restrictions and the related party disclosure requirements (>10%), both of which provisions were revoked at the same time this paragraph was enacted.

Application of Duty

The fundamental premise is that a client is entitled to any information about a broker's business relationships that pertain to a transaction or recommendation.

A business relationship means any direct or indirect interest or benefit that is relevant to the transaction or arises from placing, or the recommendation to place, a contract of insurance with a particular insurer (over another).

The interest must be sufficient to raise the perception of "influence" over the broker's "independent" decision making process, in the mind of a reasonable person, in possession of all the facts. In other words, the influence must be "material" enough that a reasonable person would believe that a consumer could not make an "informed" decision without that knowledge.

In all cases, we include "individual" conflicts of interest, as well as those of the registered "firm", as the case may be. In all cases as well, the guidelines are intended to deal with situations where non-disclosure would be detrimental to consumers.

Guidelines

This provision as drafted is very broad in scope. Accordingly, to provide guidance to brokers in understanding what this provision means in order to comply, the following Guidelines set out RIBO's interpretation of what this disclosure requirement means for brokers, and sets out a number of factors that may give rise to "influence" sufficient to require disclosure.

1. ANY DIRECT OR INDIRECT OWNERSHIP INTEREST OF ANY KIND IN A BROKERAGE BY AN INSURER, OR IN AN INSURER BY A BROKERAGE.

This disclosure required under section 11 of O. Reg. 991 was revoked when the ownership provisions were revoked to make way for the new disclosure requirement. There is no longer a 10% share ownership threshold before disclosure is required. This threshold has disappeared so that **any** "ownership" interest would now require disclosure, including those situations whereby shareholder's agreements provide for direction and control over the brokerage, regardless of voting rights or number of shares held.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is influenced in placing a policy with a particular insurer because of an "ownership" relationship between that broker and that insurer, that relationship must be disclosed to the client.

2. COMMON OWNERSHIP OF A BROKERAGE AND AN INSURER BY A FINANCIAL CONGLOMERATE OR OTHER HOLDING COMPANY OR GROUP OF COMPANIES.

This relationship was also required to be disclosed by section 11 of the Regulations. Now, however, the requirement to disclose related party situations is much clearer.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is influenced in placing a policy with a particular insurer because both entities are owned or controlled by another common company or group of companies, that relationship must be disclosed to the client.

3. A LOAN, CREDIT FACILITY OR OTHER FINANCIAL RELATIONSHIP, DIRECT OR INDIRECT.

Influence can be exerted on a broker by other means than having a direct, indirect or common "ownership" relationship with an insurer. There are numerous historical examples of insurers either lending capital to brokerages for acquisitions or other reasons, or extending credit facilities for various reasons. These financial relationships, however provided, exert influence or control over the decision making process in the same way as an "ownership" relationship and ought therefore, to be disclosed.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is influenced in placing a policy with a particular insurer because of a financial relationship, that relationship must be disclosed to the client.

4. A FINANCIAL OR NON-FINANCIAL NETWORK AFFILIATION.

Influence may affect a broker by means other than an ownership or an actual financial relationship with an insurer. The existence of, or membership in a "network" of companies making products or services available to consumers by reason of being a member of the network, may exert influence on a broker in deciding to place insurance with an insurer that is also a member of the network. The same influence may be exerted whether the "network" access applies to financial or non-financial products.

An example might be a broker making an arrangement with a retail organization for a kiosk or place of business in their premises, when that retailer also has a relationship, direct or indirect with an insurer.

This factor deals with the "independence" of a broker from an insurer, when both are members of a group or are affiliated with the same group, in other than at "ownership" or "financial" relationship.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is influenced in placing a policy with a particular insurer because of a network affiliation, that relationship must be disclosed to the client.

5. EXCLUSIVE CONTRACT OR ONE MARKET EXCEPTIONS

The public generally considers brokers to have access to the insurance market and that a broker will shop around to obtain "the best product with the best insurer and the best service to the customer at the best price".

Some brokers, for their own business reasons, have entered into contracts with one insurer to provide all or a substantial portion of a line or lines of business to that insurer exclusively. Other brokers have innovated a particular targeted market program that is written exclusively with one insurer, for example, an "over 50" auto insurance program.

In each of these examples, while still "acting as an insurance broker" for RIBO purposes, the client is not provided a choice of insurer. The client is placed with the one insurer with which the broker has entered into an "exclusive" contract, or through whom the broker has placed the target market program. To the public, such brokers may appear as "virtual agents" of that insurer. In these cases, just as agents are required to disclose that they represent one insurer, these brokers ought to disclose this fact as well.

Some brokers might also find themselves in a limited market capacity position by reason of market conditions from time to time, such as market cancellation or withdrawal, or in some cases notwithstanding the number of contracts held. The absence of "choice" in the placement of insurance contracts is a factor that the public has a right to know prior to the placement of coverage.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is not offering a choice of insurers in the placement of an insurance product, that fact must be disclosed to the client. This applies regardless of whether the broker is in this position by contract, by specific program or by reason of finding himself or herself in a limited market situation in the ordinary course of business.

6. VOLUME OR MIX OF BUSINESS REQUIREMENTS

At times, when an insurer is reviewing a broker's contract, that insurer may impose a stringent volume or mix of business requirement on that broker, such as a requirement to submit one property application for every auto application submitted.

This factor does not apply to a broker's normal or ordinary course of business, for example, when a broker obtains a new contracted market and places risks in support of that market. This factor is intended to apply to the rare occasion when an extraordinary restriction may be placed upon him by an insurer for contractual or rehabilitation reasons. In those instances, such requirements may lead to an absence of "choice" problem that may be to the detriment of the client. If so in those cases, that absence of "choice" ought to be disclosed.

This factor means that if it would appear to a reasonable person in possession of all the facts that a broker is not offering a choice of insurers in the placement of an insurance product as a result of restrictive requirements placed on him or her by an insurer, to the detriment of a client, that fact must be disclosed to the client.

7. RECEIPT OF CONTINGENT COMMISSION

There is a perception that brokers may steer insurance business to one company over another based on contractual arrangements that provide a broker with an opportunity to receive contingent commission. While payment of contingent commission from an insurance company may depend on profitability (loss ratio) of that broker's total book of business with that insurer (and not on individual policies), or volume or growth targets in other cases, and the receipt of this commission by the broker is not guaranteed, the possibility that the broker may receive this commission in future ought to be disclosed, in order to achieve full and overt transparency in the transaction.

This factor means that if a broker's contractual relationship with an insurer provides for a contingent commission structure, that fact must be disclosed to the client.

The following is some sample wording for use in this disclosure:

"In order for us to maintain strong relationships with quality insurers we work with each to provide the type of business they desire. The insurers noted above (from list of markets) with an asterisk recognize our efforts through a Contingent Commission contract. Payment of this Contingent Commission depends on a combination of growth, profitability (loss ratio), volume, retention and increased services that we provide on behalf of the Insurer. It is based on our entire portfolio of business with that insurer and not on individual policies. Contingent Commission is not guaranteed".

8. SALES INCENTIVES

There is a perception that brokers may steer business to one company over another based on the fact that some companies offer trips or other incentives to brokers that meet certain sales targets, usually expressed in volume, growth or profit criteria.

Similar to the possibility that a broker may receive contingent commission, the possibility that a broker may receive sales incentives ought to be disclosed, in order to achieve full and overt transparency in the transaction.

This factor means that if a broker's relationship with an insurer provides for sales incentives, such as trips, that fact must be disclosed to the client.

Clarity of Disclosure

A client is entitled to full and overt transparency in the disclosure of information.

Accordingly, RIBO will consider that a broker has not complied with this requirement if disclosure is provided in a manner that is unclear or obscure, for example, disclosure of relevant information that is intentionally buried in a twenty page document that no one will read.

Examples of Disclosure

The following represent common examples of disclosure of ownership or financial relationships, some of which were taken from actual documents where this information was being disclosed prior to the current requirement coming into force.

- The policyholder and insured(s) are hereby notified and advised that the producing broker name of brokerage is owned by name of insurer, the underwriter of this policy of insurance.

- The name of insurer has an ownership interest in name of brokerage.

- Name of brokerage and the name of insurer have common ownership, or are both members of the same group of companies, as the case may be.

- Name of brokerage currently has a loan guaranteed by name of insurer that was used to expand our business.

- Name of brokerage has a financial relationship with name of insurer.

9. PREMIUM FINANCING COMPANIES

There is a perception that brokers may steer business to one premium finance company over another based on the fact that some finance companies offer referral fees to brokers.

Indeed, a number of brokers have ownership or related party interests, directly or indirectly, with premium financing companies.

While RIBO Guidelines on Marketing Practices already provide for disclosure to the client if a broker receives a referral fee, in advance of arranging the financing, the fact that a broker may receive referral fees or have an ownership or related party interest in a financing company ought to be disclosed from a conflict of interest perspective, in order to achieve full and overt transparency in the transaction.

This factor means that if a broker's relationship with a premium financing company provides for referral fees, or involves an ownership or related party interest, directly or indirectly, that fact or both those facts, as the case may be, must be disclosed to the client.