



**AUTORITÉ
DES MARCHÉS
FINANCIERS**

VIEW FROM THE AMF

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INTRODUCTION

Good morning everyone,

I'd like to begin by thanking the members of the NICC Advisory Committee, in particular Mr. Joel Baker, for giving me the opportunity to be with you today.

I would also like to thank the NICC for holding this conference in Québec.

I am particularly pleased to be with you today because I consider it essential for all of us to pursue regular exchanges on the challenges facing the financial industry.

Before I go further, it is important to mention that Joel Baker asked me to deliver my presentation in English.

So blame it on Joel if, from time to time, it sounds like a speech by Inspector Clouseau from the movie *The Pink Panther*.

My English accent is no better than the English accent of Inspector Clouseau. However, I hope that the content of my presentation will be more relevant than what Inspector Clouseau could have done.

SCOPE OF THE PRESENTATION

This being said, I would like to discuss a number of topics with you this morning.

Specifically,

- I will talk about recent developments in P&C insurance in Québec;
- I will discuss some of the reforms that we are currently contemplating regarding the distribution of insurance products;
- I will say a few words about the automobile insurance industry and its regulation in Québec;
- I will present a brief update on the AMF guidelines for insurers;
- Finally, in closing, I will discuss the type of relationship that we want to develop with the industry in Québec.

But first, a few words about the *Autorité des marchés financiers*, or the AMF, and its role in the regulation of the financial sector in Canada.

The AMF is a team of approximately 700 persons who work according to an integrated structure of activities.

This means that all regulatory activities governing Québec's financial sector (with the exception of the banks) are under the same roof.

We oversee the application of a dozen laws related to insurance, the distribution of financial products and services, securities and deposit institutions (again other than banks), and deposit insurance.

Recently, the government assigned us the responsibility of overseeing money services businesses, which include, for example, activities related to currency exchange, funds transfers and automated teller machines.

More specifically, with respect to P&C insurance, we oversee the activities of all P&C insurers doing business in Québec, regardless of where they were constituted.

In practice, this means that, in addition to overseeing prudential standards and capital requirements, as does the Office of the Superintendent of Financial Institutions (OSFI), we oversee commercial practices and the distribution of insurance products by the industry.

This integrated framework provided by a single regulator is unique in Canada and we believe it generates important benefits.

One of the main advantages is the fact that we, at the AMF, are able to have a global view of upcoming reforms and to implement them in a similar and consistent manner throughout the various industry segments.

In a more decentralized regulatory structure, the same results could only be attained through the coordination of various regulators and, as you know, this is not always easy to achieve.

With this unique framework, we face quite a challenge given the large volume of reforms that we have to put in place in the footsteps of the important work currently under way or contemplated by the G-20, the Financial Stability Board and the various international standard setters (IOSCO, IAIS, IADI).

Again, on balance, we believe that our model is advantageous even though it imposes on us a large volume of work.

Now let's get to the heart of my address today: P&C insurance in Québec.

1. DEVELOPMENTS IN P&C INSURANCE

Overview of P&C insurance offered in Québec

The P&C insurance industry is an important sector of the Québec economy.

It employs around 25,000 persons. It contributes close to \$2.5 billion dollars to the Québec economy.

As at December 31, 2011, 186 insurers held a P&C insurance licence in Québec.

- 53% of direct premiums were written by 58 insurers constituted in Québec;
- 36% of direct premiums were written by 64 insurers constituted in the Rest of Canada (ROC).
- 11% of direct premiums were written by 64 insurers constituted under the law of another country.

Premiums written in Québec totalled over \$8 billion last year, up 3.3% compared with 2010. This exceeds the average increase for the past five years, which stood at 2%.

So it is fair to say than the P&C sector in Québec is doing relatively well.

This being said, an area of concern over the past two years or so has been the increased concentration in the industry.

Indeed, since 2011, the AMF has analyzed three major transactions:

- The acquisition of Axa by Intact;
- The acquisition of Jevco by Intact;
- The acquisition of *L'Union Canadienne* by Roins Financial Services Limited (RSFL).

The impact of these transactions is significant. Indeed, following these transactions, the market share of the 5 main players in direct premiums written in Québec rose from 52% to 59%.

These transactions have also led to increased concentration in certain classes of insurance. For example, the market share of the Intact Group alone is close to 50% in surety insurance. However, this class of insurance only represented 1.4% of P&C insurance premiums in Québec in 2011.

A number of commentators have asked us if we were, at the AMF, concerned about the increased concentration of the industry.

The answer is clearly yes.

We believe however that we have not yet crossed the critical threshold beyond which mergers and acquisitions would be detrimental to consumers. But we are certainly very close to this breaking point.

In analyzing this issue, a number of factors must be considered.

- The overall degree of concentration and its impact on:
 - price competition and
 - the availability of an adequate array of products for the consumer;
- The impact on regional markets within Québec.
- The impact on distribution networks.

With respect to the overall degree of concentration, one way to examine this aspect is to look at the Herfindahl-Hirschman Index. This index is used by the U.S. Department of Justice to measure market concentration:

- When this index is below 1000, the market is considered competitive.
- When the index is between 1000 and 1800, the market is considered moderately concentrated.

Following the recent acquisitions, the Herfindahl-Hirschman index for the P&C industry in Québec stands at 1050. We are now entering the zone where the industry is considered to be concentrated, although moderately.

Another aspect related to mergers and acquisitions that we must also examine carefully is the impact on the distribution network.

The distribution network in Québec is composed of brokers that, to a large extent, sell the products of a limited number of insurers. In fact, studies show that a majority of brokers sell the products of no more than 3 insurers.

This situation raises important concerns for consumers when they deal with brokers. They do not necessarily get a recommendation based on the analysis of a wide array of products.

This is why the regulatory framework in Québec requires brokers to disclose to the consumer, under specific circumstances, the nature of their business relationship with an insurer.

Just to give you an example, P&C insurance brokers must, before offering an insurance product, verbally disclose to clients the names of the insurers with whom the brokers have a business relationship and specify the nature of the relationship (direct or indirect interest in the ownership of the firm, loans granted or any other form of financing by the insurer, and risks placed with the insurer representing 60% or more of the total volume of risks placed by the firm).

This being said, further mergers and acquisitions could create a difficult situation for a number of brokers who would see the array of products they offer shrink further.

It would then become difficult to argue that they comply with the Québec Distribution Act that establishes that brokers have an advisory role which requires, among other things, that they offer consumers the product that best meets their needs.

The bottom line is that the AMF is concerned about the impact of recent mergers and acquisitions.

It is now clear that any other transaction that would significantly increase the concentration in the industry would run the risk of triggering a negative recommendation by the AMF to the Minister of Finance who, ultimately, has the responsibility of approving the transaction.

2. DISTRIBUTION REFORMS

I would now like to say a few words on the work currently under way at the AMF regarding the distribution of financial products and services. Two files are of particular interest for the P&C industry:

- The distribution of insurance through the Internet;
- The review of the financial services compensation fund.

Insurance distribution through the Internet

In Québec and elsewhere, the models and methods of distributing P&C insurance products constantly evolve. Not so long ago, a market dominated by brokers saw the introduction of distribution by captive agents. Today, alternative distribution channels are emerging.

E-business in general is booming. For instance, in 2010:

- Nearly 22 million Canadians, or 80%, used the Internet for personal reasons.
- Of those, 51% purchased goods or services on-line.
- The 114 million on-line orders made that year were worth just over \$15 billion (62% increase in orders and 20% increase in value compared with 2007).

Although insurance offerings on the Internet are not growing at the same pace, they nonetheless form a vibrant sector.

Unfortunately, data on the use of the Internet in the insurance sector in Québec are not readily available. An idea of the potential evolution of the industry can be obtained by looking at data from our neighbour south of the border.

In the United States,

- Over 32 million car insurance quotes were obtained on-line in 2008, 15% more than in 2006.
- 2.9 million car insurance policies were purchased over the Internet in 2010, 35% more than in 2007.
- 63% of consumers who shopped around for car insurance in 2009 obtained a quote on-line.

The AMF goal with respect to insurance distribution through the Internet is to update the current rules so they adequately protect consumers, regardless of how an insurance product is purchased.

It is important to note that the Distribution Act in Québec was written largely in the 1990s, when Internet was much less extensively available and certainly not widely used to distribute insurance products.

The Act needs to be modernized and there is a need to be proactive because the obsolescence of the regulatory framework could create uncertainty and could lead to the emergence of questionable practices in the industry.

With this in mind, the AMF held a consultation regarding the on-line distribution of insurance products and the issues associated with it that ended in May 2012.

The goal is to establish basic principles and address a number of issues related to the use of the Internet in insurance distribution.

For example:

The security of the transaction

The Internet presents the potential for sophisticated fraud. At the AMF, we have a group specifically dedicated to cyber-surveillance and we are in a position to assess what this potential can represent.

For example, when using the Internet, how can you be sure that you are effectively on-line with an insurer having a valid licence in Québec?

As well, how can you be sure that the information that you transmit through an Internet site is secure?

Obviously, best practices exist in this area. For example, banks have been offering Internet transactions to their customers for quite some time.

Furthermore, the staff of the AMF has had the opportunity to review through on-site visits the measures put in place by a number of insurance companies involved in Internet distribution and we were generally satisfied with what we saw.

The challenge for regulators is making sure that best practices are adopted by all participants in the industry.

Another challenge is making sure that consumers are aware of the risks involved and are in a position to recognize signs that would indicate potential fraud.

We are planning to develop and/or improve our consumer education programs in this regard.

The role of the licensed agent

On the Web, there is substantial information asymmetry between the consumer, who often knows little about insurance, and the insurer, who is a specialist in the subject.

In conventional distribution channels, the intervention of a licensed representative narrows this information gap.

With insurance distribution through the Internet, we need to ask ourselves if the role of the licensed representative needs to be maintained, rethought, or simply ignored.

There is a fundamental debate going on in the industry on this question:

- Brokers and licensed representatives argue that their advisory role is essential and must be maintained.
- Many insurers argue that with the Internet, it is possible to standardize information and through standardization of information provide a clear advantage for consumers.

This is an important question. Clearly, Internet distribution could impact on the role traditionally played by certified representatives and, possibly, limit their business.

One option could be to require that insurers have a certified representative available at all times in the event that a consumer wishes to ask specific questions.

A more constraining option would be to have each individual Internet submission reviewed by a certified representative.

Currently, there is clearly no consensus on a preferred approach.

Comparison sites:

Comparison websites are increasingly popular (particularly with respect to P&C insurance).

They enable the consumer to submit a single proposal and receive quotes from several insurers in one place.

However, there are a number of issues related to these sites. For example,

- Their independence, and more importantly, their ability to provide unbiased quotes;
- Whether or not they are involved in transacting insurance and are therefore subject to regulation (registration).

This is a brief sample of issues that we are currently examining in the context of the review of insurance distribution through the Internet.

On the practical side, the Canadian Council of Insurance Regulators (CCIR) undertook a consultation similar to that conducted by the AMF.

Close to twenty briefs were submitted by the industry and they are currently being analyzed by the CCIR.

This measure is expected to give rise to a report giving provincial regulators some leeway in implementing the recommendations and adapting them to their situation.

Specifically, in Québec, we would like to propose amendments to the Distribution Act sometime in 2013.

Financial Services Compensation Fund

Another area related to the distribution network involves our financial services compensation fund, the *Fonds d'indemnisation des services financiers*.

The financial services compensation fund may compensate victims of fraud, fraudulent tactics or embezzlement who have conducted business with individuals and companies authorized to operate under the Distribution Act or in connection with mutual funds or scholarship plans.

There are few compensation precedents in the P&C sector but two are well-known:

- In the Loyalist's case, the fund paid \$3.9 million in compensation to 210 claimants. Firms used the Lloyd's name and kept the insurance premiums paid by their clients.
- Recently, in the Hallé case, the Fund paid approximately \$50K to 13 claimants in compensation. Hallé's firm had misappropriated premiums paid by its clients and had created false insurance policies.

This being said, there has been some frustration in Québec with the operation of the compensation fund, especially in the context of a number of major frauds that occurred over the past decade (Norboung, Mont-Real, Triglobal, etc.).

Some of these frauds involved losses in excess of 100 million dollars. However, investors were not or were only partially compensated by the fund.

In this context, the AMF launched last year a public consultation. A number of important issues were raised. For example:

- The type of fraudulent activities that should be covered by the fund;
- The level of compensation payments;
- Mechanism to reduce moral hazard;
- The governance of the fund.

Globally, a fundamental issue is whether the fund should be more generous. Indeed, this could financially impact the representatives from all segments of the industry (including P&C) that finance the fund through their contributions.

A consultation report will be prepared summarizing the comments received and recommending orientations. The report is expected to be released this fall.

3. RECENT DEVELOPMENTS IN QUÉBEC AUTOMOBILE INSURANCE

I would like now to say a few words about recent developments in automobile insurance

But before I do so, I'd like to highlight some of the features of Québec's automobile insurance regime.

Québec's current automobile insurance regime took effect on March 1, 1978 with the *Automobile Insurance Act*

A no-fault regime

Among other things, the Act establishes a no-fault regime for bodily injury resulting from an automobile accident.

- Bodily injury caused by an automobile in Québec is compensated by the State through the *Société de l'assurance automobile du Québec (SAAQ)*.
- Under this system, no attempt is made to determine who is at fault when someone is injured in an automobile accident. As a result, the innocent victim and the person who is responsible for the accident will both be compensated by the SAAQ in the same manner and on the same basis.
- With respect to material damages, liability insurance for damage to another person's property is mandatory while insurance covering damage caused to a person's own vehicle is optional.

Standard automobile insurance policies

- As well, under the Québec *Act respecting insurance*, the automobile insurance policy is standardized by the AMF and all insurers must use it.

Approval of rates and underwriting criteria

In Québec, contrary to many other Canadian provinces, the AMF does not approve rates, that is, premium levels, or the underwriting criteria used by private insurers, giving the insurers a competitive edge.

Recent developments

So, what's been happening in automobile insurance recently?

- In 2011, the volume of premiums written was over \$3 billion while the total amount of losses covered by insurers was close to \$2 billion. The loss/premium ratio therefore stood at roughly 60%.
- There has been a consistent decline in claim frequency over the past 10 years. This has allowed insurers to post a robust loss experience and thus generate healthy profits.
- Profits represent an estimated 12.3% of premiums written in 2011, while the average profit generated by insurers over the past 10 years is 14.5% (10.3% calculated over a 20-year period).
- Insurers' rates have decreased for the ninth consecutive year. In 2011, the average decrease was 2%. The average premium written has therefore dropped by close to 10% since 2004, from \$589 to \$536 in 2011.
- According to 2010 data, Québec has the lowest automobile insurance costs. As an example, the average cost of insurance is \$1,482 in Ontario, compared with \$720 in Québec (including the cost of the public regime).

An important development in Québec over the past few years has been the regulatory reform of replacement insurance.

During the mid-1990s, automobile dealers developed a product called the "replacement guarantee" to allow consumers to obtain a new vehicle in the case of a total loss. This product was sold exclusively by car dealers.

Many consumers faced important difficulties with this product. It was not legally considered to be an insurance product, although it had all the major characteristics. Accordingly, it was not subject to any prudential or market conduct obligations. Furthermore, it was largely financed on a pay-as-you go basis by car dealers or other firms involved in manufacturing the product. Many consumers were denied coverage when car dealers were facing financial difficulties.

Following numerous consultations, the AMF published in 2009 a notice stating that motor vehicle replacement guarantees currently being sold by automobile dealers were an insurance product subject to AMF oversight.

As a result, automobile replacement guarantees are now issued by insurers and are the subject of a standardized form approved by the AMF.

It is worth noting that this product may be sold directly by insurers and brokers, or it may be sold pursuant to provisions covering distributions other than through a representative, namely, by an automobile dealer. This is an exception to the general approach to the underwriting of automobile insurance products in Québec.

From October 1, 2010 to December 31, 2011, just over 107,000 policies were written, for a total of over \$159 million in premiums.

Distribution other than through a representative, that is, by automobile dealers, accounted for over 90% of all policies sold during this period and close to 93% of all premiums written.

Lastly, the AMF has worked with an agency called the *Groupement des assureurs automobiles (GAA)* to develop an automobile insurance policy in simplified language.

The GAA is the umbrella group for all insurers underwriting automobile insurance in Québec. Its main role is to manage, as an AMF representative, the *Agence statistique* (statistical agency) and the *Fichier central des sinistres automobiles*, a database of automobile insurance claims.

It became necessary to develop a policy in easy-to-understand language since current contracts were drafted by and for experts. As a result, only parties well versed in legal jargon and the insurance field are able to fully understand them.

Redrafting automobile insurance policies in easy-to-understand language fits in perfectly with the objectives set by the AMF with respect to consumer protection and consumer education. This initiative is also in keeping with what is being done internationally with respect to financial awareness.

An official publication will be released at the beginning of 2013. Insurers and other industry stakeholders will have from 8 to 12 months to prepare before new policies take effect.

4. UPCOMING GUIDELINES FOR P&C INSURERS

I would now like to update you on our work on guidelines for P&C insurers.

Amendments to the Minimum Capital Test (MCT) Guideline for 2013 were published on September 27, 2012 on the AMF website. Changes are minimal compared with the 2012 version. As for the previous versions, we worked with OSFI and the industry on the content of the amendments in order to harmonize our guidelines.

We also published for consultation, on the same date, a revised version of our earthquake exposure risk management guideline. It is harmonized with OSFI's Guideline, except that, contrary to OSFI, we have not included a section for the calculation of the MCT to cover this risk.

We still have to better assess the magnitude of the proposed changes and their impact on insurers doing business in Québec. We will consult the industry probably in the spring of 2013.

A third consultation is under way, with the amended version of our Reinsurance Risk Management Guideline. A Guide for Guarantee Instruments has been drafted to offer more flexibility to insurers for the recognition of different guarantee instruments to allow for the possibility of the ceding company being eligible for a capital credit in respect of unregistered reinsurance.

I invite you to provide us with comments on these important amendments.

Finally, we are still working on our Commercial Practices Guidelines. So far, it went through two public consultations. A difficulty with this guideline is to strike a proper balance between what should be included in this guideline and what should be part of the Distribution Act. This question is currently being examined with the Department of Finance.

5. CONCLUSION : OUR RELATIONSHIP WITH THE INDUSTRY

As you can see, there is a lot going on at the AMF regarding the P&C industry.

Our challenge as a regulator is to keep a steady pace and be able to conduct real-time assessments of the risks presented by product offerings to ensure stability not only for the markets, but also for investors.

As I mentioned earlier, our aim is to help your industry develop rather than merely act as a watchdog.

Some financial regulators argue that they should keep their distance from industry. Indeed, some commentators claim that if we're too close to industry, our decisions and rules will be tainted, that we'll be at the industry's mercy. I can tell you very clearly that I do not agree with this position.

On the contrary, I believe we should maximize opportunities for discussions and meetings with industry.

Of course, we're already doing this in a quite formal setting. The regulatory and normative (guideline) consultations we conduct on a regular basis are an example of this, but I'm convinced that we should go further because the quality of our regulatory initiatives will improve as we arrive at a better understanding of the realities of your industry.

If we at the AMF come across a situation that we're having trouble to fully grasp, I think it is quite appropriate to establish contacts to gather information or to inquire about operations in the field.

We at the AMF therefore have a strong desire to establish an ongoing dialogue with you that will help us better understand the issues facing your industry.

To some extent, that's what I am doing here today.

Thank you for your time.