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Résumé de l'article

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The Complex Regulation of Annuity Deposits

by

Jean-Pierre Bernier*

Les rentes viagères proposées par diverses institutions financières, principalement les banques et les assureurs, attirent depuis longtemps les Canadiens. L'auteur s'interroge sur la complexité et le manque d'harmonisation dans la réglementation actuelle, en ce qui concerne leur émission et leur distribution.

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Are licensing requirements and marketing regulations really necessary for the distribution of life company GICs in Canada?

For decades, Canadians have been able to buy insurance annuities and non-insurance annuities. They have also been able to save money in bank deposits and non-bank deposits. The characteristics that distinguish these financial products from one another are not generally understood by the public. However, for regulatory purposes their respective differences are of paramount

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importance. In Canada's highly regulated financial services industry, where there exist multiple regulators, the distinctions (whether established by legislation or by court decisions) serve the useful purpose of delineating the scope of each regulatory framework. The federal banking regulator has no authority over the distribution of insurance. The provincial insurance regulatory bodies cannot oversee the taking of deposits by banks.

Briefly stated, when a consumer places $5,000 in a bank GIC, also called a certificate of deposit, for three years, he or she is lending that money to the bank for that length of time. The bank-customer relation is that of debtor-creditor. If the same funds were deposited into a life company three-year deferred annuity policy, the consumer would be buying a right to receive, at maturity of the policy or on the policyholder's death, income in the form of a lump-sum cash payment or a stream of future income payments. Since life company deferred annuities, also called money-accumulation annuities, are perfect substitutes for bank GICs, they are often referred to as life company GICs. The insurer is not indebted to the client until the income becomes payable.

As a matter of interest, several life insurers have consolidated the administration of their deferred annuities into one business unit with that of their trust company subsidiaries' GICs. Reduction of costs was the primary motive.

In both cases, the consumer (a depositor in one case, a policyholder in the other) would be fully protected in the event of the insolvency of either the banking institution or the life insurance company. Indeed, while the bank's three-year GIC would be covered by the Canada Deposit Insurance Corporation (CDIC), the life company GIC would be guaranteed by the Canadian Life and Health Insurance Compensation Corporation (CompCorp). It is noteworthy that the maximum protection provided by CDIC and CompCorp would be the same— namely, $60,000 per depositor or policyholder per financial institution.

Life annuities are exceptional

An insurance annuity is essentially an annuity policy that is issued by a life insurance company. Property and casualty insurers are not allowed to issue annuities. Federally incorporated life insurers have been empowered to issue annuities of all kinds, including GICs, since 1927. Prior to that date, they were restricted to life annuities—that is, annuities with a life contingency. Under the *Insurance Companies Act* (Canada), "policy" is specifically defined to include any annuity contract.

On several occasions, the courts have determined unequivocally that insurance products and their distribution fall exclusively under provincial authority. In line with these decisions, all 10 Canadian provinces have adopted statutory provisions that assimilate the annuities of life companies to life insurance. Moreover each province requires that life company annuities, of whatever kind, be distributed under a life insurance licence and be subject to insurance marketing regulations.

A non-insurance annuity is an annuity that is issued by an entity other than a life insurer. Banks and other non-insurance financial institutions in Canada are able to issue annuities of all kinds except life annuities. In fact, many banks and trust companies have offered term annuities for years, either directly in their branches or through financial planners and annuity brokers. In the case of banks, the *Bank Act* (section 416) prohibits no more than the issuance of annuities with a life contingency. Life annuities have always been, and continue to be, the exclusive domain of life insurers. However, life-time RRIFs are not regarded as life annuities. Whereas the sale of insurance annuities is regulated, the distribution of non-insurance annuities is not. Like banks and near-banks, many charitable organizations and an increasing number of universities market annuities without a licence.

It is interesting to note that, although provincial securities legislation define a security as including "any income or annuity contract not issued by an insurance company", at present, non-

insurance annuities are not treated as securities. Bankers and annuity brokers selling the term annuities of banks are not required to obtain a securities licence.

Bank GICs are nothing more than banking

Banks are in the business of accepting deposit liabilities. When a bank issues a certificate of deposit or GIC, it carries on the business of banking. Bank GICs are deposits. They form an integral part of banking over which the federal government has exclusive regulatory competence. There are no rules under the *Bank Act* or its regulations that govern the marketing of bank GICs.

The acceptance of deposits is not the monopoly of banks. Trust companies, credit unions, and life insurers are empowered to, and do, accept deposits. Although bank deposits are banking, non-bank deposits are not. This was the essence of a 1980 decision of the Supreme Court of Canada in *Canadian Pioneer Management Ltd.* v. *Labour Relations Board of Saskatchewan* [1980] 1 S.C.R. 433)

The deposit-taking power granted to federal life insurers by the *Insurance Companies Act* (section 467) is restricted to deposits that are permitted by the Act. Deposits that are necessary to carry on the annuity business are allowed as long as they are part and parcel of annuity policies. The notion that deposits are intrinsic to annuities has been well recognized by the Canadian judicial system. Indeed, in 1958, the Supreme Court of Canada in *Gray* v. *Kerslake* ([1958] S.C.R. 3, at p. 19) decisively stated with respect to life company annuities that "their usual purpose is simply to provide, by the deposit either of a lump sum or of payments over a period of years, a sum of money sufficient, with accumulated interest, to provide an annuity to commence in one's later years, either for the life of the annuitant or for a fixed term of years."

The life insurers' annuity business is significant. This state of affairs is due largely to the fact that Canadians have become more concerned about living too long than dying too soon.

According to Standard & Poor's, at year-end 1992 annuity reserves represented about 75% of the Canadian life insurance industry's total reserves in Canada. Today, an increasing number of life companies derive more than two-thirds of their premium income from annuities.

The sale of life company GICs is not simple

With very few exceptions, life company GICs are offered to the public under the same provincial marketing regulations that govern insurance. These rules are far from being uniform throughout the country. In many areas, different requirements, standards, and regulatory approaches exist among the provinces. The inconsistencies are so numerous and widespread that it would take months of the author's time just to do an inventory. In certain provinces, the task would be difficult given the number of (unwritten) discretionary rulings made by the insurance regulators. The regulatory changes are not made with interprovincial standardization in mind. Quebec insurance marketing regulations were overhauled in 1989 with the adoption of the *Market Intermediaries Act,* which is unique in Canada. The Act will be revisited against his year under its five-year sunset clause. Alberta has recently initiated its own revision of the rules concerning the distribution of insurance in the province. An unprecedented proposal to license the authorized insurance retailing activities of banks has been put forward. Ontario has dropped the comprehensive Insurance Legislation Review Project calling for a renewal of the *Insurance Act* in favour of a few limited and narrowly focused amendments. In five provinces, the regulatory responsibility is split between the government and a local industry-run Insurance Council, resulting in layers of regulations that often overlap. In striking contrast with the Canadian Securities Administrators, the Canadian Council of Insurance Regulators lacks the institutional structure required to deal effectively with regulatory harmonization. In all of Canada, current insurance marketing regulations continue to be based on principles that were established during a different era. They have not kept pace with the evolution of the

marketplace and the modernization of company laws. At the end of 1992, the Ontario Minister of Financial Institutions publicly stated: "*Ontario's Insurance Act* was passed in 1924 and, despite certain amendments over the years, has remained largely unchanged since that time." This is the context in which life company GICs are distributed today.

There are no consumer benefits arising from excessive, unnecessary or obsolete regulation, regulatory duplication, and disharmony of governing provisions. They all add to the costs of doing business, ultimately adding to the price consumers pay for financial services. In the ease of GICs, where marketing regulations apply to one product and not to another, some financial institutions are placed at a disadvantage relative to others.

Regulatory compliance is costly, more so when the regulatory framework is fragmented and the rules are incoherent. Cost estimates are difficult to make because some factors are not easily measurable and many others are diffused over various business units of the same corporate organization. With respect to life company GICs, certain compliance costs are especially onerous—for example, the funding of multiple regulatory bodies, the licensing requirements, the internal administration apparatus required to deal with a plethora of regulations, the implementation of regulatory changes on a province-to-province basis, the frequency at which these separate changes (minor and major) are occurring, the expenses associated with making representations to governments and regulators across the country, and, last but not least, the time and effort directed toward skirting regulatory barriers that could be targeted at more economically useful purposes. With the growing complexity of insurance marketing regulations (and other applicable regulations—for example, networking, mutual funds, financial planning, and consumer disclosure requirements), full compliance with every rule at all times is now a concern.

In an increasingly competitive environment, it has been said many times by life company CEOs and other business

executives that low costs are absolutely essential to ensure strong growth in the future and that every effort should be made to standardize regulations and to remove unnecessary rules.

Unnecessary regulations should be removed

It was with this approach in mind that the life insurers strongly endorsed the 1992 recommendation of the Ontario Insurance Legislation Review Project (ILRP) to repeal the statutory prohibition against the offering of inducements for the purchase of life company GICs and other annuities. Banks, trust companies, and credit unions can and do provide inducements to consumers who purchase savings instruments. The industry also responded with a counter-proposal to the Ontario government that consideration be given to exempting annuities from other prohibitions, such as the one against rebating. A few precedents already exist for treating the sale of annuities differently from that of life insurance. For instance, the prescribed life insurance disclosure form for policy replacement does not apply to annuities.

The reasoning of the ILRP for its recommendation aimed at a level playing-field in the distribution of GICs in Ontario is worth repeating here: “many (life company) annuities are issued as term or demand savings vehicles that compete directly with the savings vehicles offered by deposit-taking institutions. Newspapers publish comparison charts featuring interest rates offered by banks, trust companies, and life insurance companies. Consumers generally shop for the best rate.”

This article is not intended to imply that life company annuities should no longer be insurance products or that their distribution be totally unregulated. What is suggested, as a personal view of the author, is the need for a unitary regime under self regulation whereby management of life insurers or the industry as a whole would be responsible for determining prudent market practices and for ensuring compliance with them. It is essential that adequate standards of consumer protection be maintained. The in-branch distribution of bank GICs is well

regulated by the individual banks without being a licensable activity. Inconsistency in marketing rules and associated high costs would not be an issue for life company GICs if the standards and enforcement measures were those of a respected nationwide industry organization such as the Life Underwriters Association of Canada, to the exclusion of standards set by individual regulatory bodies. In cooperation with all 10 Canadian provinces, the establishment of an industry-run National Life Insurance Council responsible for the education, licensing, supervision, and discipline of all life insurance agents would achieve the same results.