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**Reference Document:
IVIC SUITABILITY
NEEDS-BASED SALES PRACTICES**

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1. INTRODUCTION

1.1 Purpose

The document describes industry practices intended to clarify the relation of the features of an Individual Variable Insurance Contract (IVIC) to the needs of a client.

It is important to bear in mind that the circumstances of individual clients will vary considerably. For this reason, the applicability of specific practices described in this document, except those that are required by statute, can only be determined by taking into account the circumstances of a specific transaction.

The needs-based sales practices described in Section 4 are carried out by advisors. This section is intended to expand on and provide practical guidance in the area of IVICs to help advisors understand the more general advice in *The Approach*, a 2007 reference document that was prepared jointly by Advocis, CAILBA, CLHIA and IFB.

The practices related to product design and information, training and oversight are generally carried out by insurers. In some cases, however, insurers may delegate training or oversight functions to another party, such as a Managing General Agent.

1.2 Background

The IVIC is one of many wealth management products designed to address a variety of needs. The IVIC is a highly flexible product that can be used on its own or in combination with other wealth management products. Advisors need to understand the features of this product and how it fits with client needs in order to include it in a suitable recommendation.

When it became a mainstream retail product in the mid-1990s it was primarily used for capital accumulation. It provides consumers with the upside potential of investing in market-linked funds while allowing them to enjoy protection against the down-side risk of market declines. This protection is provided in mandatory 75% death and maturity benefits. Many contracts allow the consumer to increase these benefits to 100 percent. In 2006, with an increasing number of Canadians approaching retirement years, insurers began adding income protection in the form of guaranteed withdrawal benefit (GWB) features. These optional benefits are continuing to evolve and currently guarantee income for life or a specified period.

For many consumers, the decision to purchase an IVIC usually revolves around these guarantees and the role they play in providing a desired level of financial security. But the fact that IVICs are life insurance contracts means that they provide insurance features such as probate bypass and potential creditor protection that, for some, are important reasons to purchase the product.

Insurers and advisors both have important roles to play in ensuring that the product is appropriate for consumers. The task of the insurer is twofold, to design a product that functions in a reliable and predictable manner and to create product information outlining this for advisors

and clients. The task of the advisor is to identify the financial needs of the consumer to ensure the IVIC product is suitable for them in light of their particular circumstances and then assist the consumer in understanding how the product meets his or her financial needs.

Industry practices intended to address issues related to the suitability of IVICs fall under four general areas:

- development of the product and related information
- training of the field force
- product-specific guidance related to needs-based sales practices
- oversight of sales practices

This document describes practices in each of these four areas.

2. PRODUCT DESIGN AND INFORMATION

2.1 Product Design

In designing products, insurers make a number of assumptions about consumer behaviour. These assumptions cover a range of variables including: who will purchase the product, what optional features they will select, how long they will live and a number of discretionary choices the client might make once he or she has entered into the contract. These choices are about fund selections, surrenders, payment of additional premiums, resets of guarantees and deferrals of payments.

The accuracy of these assumptions about consumer behaviour is critical to assessing the risk that the insurer is assuming with the product. Accordingly, insurers have an interest in ensuring that these assumptions are aligned with the marketing and end use of the product. This interest is addressed by, among other things, ensuring the product is accurately described in the information insurers provide and, as much as possible, accurately understood by both advisors and consumers.

2.2 Product Information

Having access to accurate information about a product is a key to providing sound advice and making an informed decision.

The central disclosure document is the Information Folder. The content and delivery requirements for the Information Folder are set out in CLHIA Guideline G2. Among other things, the delivery requirements include client acknowledgement of receipt. Since 2011, the Information Folder has included Fund Facts and Key Facts. These documents have prescribed formats that are intended to provide brief, plain language descriptions of the investment options and the contract features respectively.

Since the introduction of GWB features, many insurers have started providing illustrations to more effectively explain to clients how these guarantees work. Generally accepted practices for GWB illustrations are described in CLHIA Guideline G15.

Many insurers offering IVICs provide asset allocation software or questionnaires to assist clients in selecting an appropriate mix of investment options.

Finally, and not to be overlooked, there are a number of regulatory and industry standards related to product information about IVICs and how it is provided. At the most general level, insurers are prohibited by statute from engaging in any unfair or deceptive act or practice. This standard applies to any information insurers prepare about their products, including advertising.

3. TRAINING

As with any complex life insurance product, disclosure documents and other consumer information prepared by the insurer are generally intended to complement the role of the advisor in ensuring the consumer is able to make an informed purchase decision and use the IVIC appropriately. In addition to helping direct the client towards the most relevant information, the interactive two-way dialogue between the advisor and his or her client is often the best indication of the client's understanding.

In addition to the product information prepared for consumers, insurers also develop more technical information that is specifically intended for professional use. This typically includes a summary product guide, sales concept material and an operations or administrative guide. The sales concepts, in particular, provide detailed advice about product suitability by showing how the product can be used in certain circumstances for certain purposes. All of these materials generally include information about how advisors can receive additional support from insurers.

Advisor training and support provided by insurers is designed to prevent unacceptable sales practices such as poor needs analysis, failure to assess suitability of the product for the client, misrepresentation and misuse of illustrations. As well, it is part of an insurer's efforts to address its broader responsibilities in relation to the distribution of their products. In this regard, CLHIA Guideline G8 provides that insurers should establish a system to monitor agents that is reasonably designed to ensure that agents comply with relevant legislation, the insurer's Code of Conduct and other industry standards.

4. NEEDS-BASED SALES PRACTICES

The Approach, a Reference Document jointly prepared by Advocis, CAILBA, CLHIA and IFB, describes the steps that advisors take to develop needs-based recommendations about life insurance products. This Reference Document explains how the process described in *The Approach* can be applied to sales of IVICs.

The three steps that are relevant to developing a recommendation are:

- fact finding
- needs assessment
- recommendations and advice

In reading the description of these steps in this Reference Document, it is important to keep in mind that the process is not linear. In fact, most sales transactions will involve going back and forth and revisiting each of these stages to refine an understanding of the client and how various products and features can meet his or her needs. Equally, the steps do not produce a formula with specific questions and answers leading to a single conclusion about what might be suitable for a client.

Each of these steps requires skill and judgment on the part of the advisor. As noted in *The Approach*, the specific questions the advisors should ask will vary depending on the circumstances of the individual client and the complexity of the products being considered. Of the three steps, fact finding is the most objective but even here the advisor must decide on an appropriate level of inquiry and choose an approach that will effectively elicit the information required to identify the client's needs. The process of assessing needs introduces more subjectivity. It requires that the advisor make judgements about the priorities of the client and differentiate between wants and needs. Finally, the development of recommendations is the most subjective as there will seldom be a single preferred or optimal product recommendation to address the needs that have been identified.

Although fact finding, needs assessment and recommendations are described separately in this document, they will generally form part of a seamless sales process that may occur in a single meeting or a series of meetings between the advisor and the client.

The information that is gathered during this process and the rationale for all recommendations should be accurately and completely documented.

4.1 Fact Finding

Fact finding generally begins with a preliminary assessment of the client's circumstances. This typically informal discussion is used to determine specific areas of interest so more formal inquiry can be targeted and efficient.

Some markers that can be used in a preliminary assessment as indicators that an IVIC is a suitable product include:

- professional and/or entrepreneur: may indicate a need for creditor protection
- older: may indicate a need for probate by-pass
- conservative investment profile: may indicate a need for guarantees
- large estate: may indicate a need for privacy, probate bypass
- approaching retirement: may indicate a need for income guarantees

This is not an exhaustive list. Given the flexible nature of the product, there is a lengthy list of client circumstances that can be addressed by the features in an IVIC.

More detailed questions following the preliminary assessment focus on acquiring a better understanding of the client's needs to help determine whether or not an IVIC can form part of a suitable product allocation. For each of the specific features, the objective of fact finding and sample questions are described below. The sample questions are intended to be illustrative of the type of questions advisors might ask. With experience, advisors will inevitably gain comfort with specific questions that they find to be most effective to understand their client's circumstances and needs.

4.1.1 Basic Contract

Death and maturity guarantees on capital and insurance features (i.e., creditor protection, probate bypass, etc.) are common to all IVICs. The objective of fact finding in this area is twofold:

- determine the extent to which the client needs or wants up-side opportunities (capital gains) and protection against down-side risks (capital losses)
- identify the extent to which the client needs insurance features such as creditor protection, probate bypass, death benefit

Sample Questions

The following are potential areas of enquiry, and likely will not be applicable in every situation. This list is intended to stimulate effective fact finding strategies, not set out minimum areas of enquiry.

- Do you have life insurance?
- Do you need creditor protection?
- Do you have any dependents?
- Are they involved in your financial decisions?
- Do you have goals for your money after you die?
- Do you have a will?
- Are you concerned about the ability of your heirs to manage their finances?
- How much money will you need when you retire?
- Are you comfortable with market fluctuations?
- Are you comfortable with the risk that you could lose some of your original investment
- Do you like to make investment decisions?
- Do you want your beneficiaries to get their money quickly?
- How important is privacy to you?
- How long do you plan to hold the investment?
- What do you plan to do with the money in the future?

4.1.2 Income Guarantees

IVICs with GWB features provide the client with a guaranteed stream of income for either life or a fixed period. For almost all clients, GWB income will be a portion of the client's retirement income stream. The objective of fact finding in this area is threefold:

- identify the client's overall retirement income needs
- identify the sources, amounts and extent of risk associated with client's expected retirement income streams
- identify the extent to which risks line up with risk tolerance

At the end of the day, any recommendation about the GWB feature should include a recommendation about how much of a client's total portfolio should be allocated to GWB products. To make this recommendation, the advisor needs to determine how a specific allocation to the GWB stream fits within the client's overall financial mix to address a number of factors. In developing the recommendation, the advisor may wish to obtain information about the client's:

- overall liquidity needs
- potential risk or volatility in other income streams
- need for continued capital growth to provide future income
- contingency funds for unexpected expenses
- need for capital preservation to build or maintain an estate
- need for tax efficiency

Sample Questions

There are many ways that the advisor can obtain the information necessary to provide informed advice regarding the applicability of GWB products. The following questions cover many areas, not all of which will be applicable in any given situation, and they are not exhaustive. They are meant to stimulate effective fact finding strategies, not set out minimum areas of enquiry.

- How many years do you expect to need income?
- Are you concerned about running out of money?
- Do you require access to your capital?
- What other investments do you have?
- When do you need your money?
- What guaranteed sources of lifetime income do you have?
- Do you have a Defined Benefit pension?
- What, if any, other sources of income do you have? Or will you have?
- Are you concerned about inflation?
- Do you want to protect income for your spouse or partner?
- What level of income do you require for necessities?

4.1.3 Investment Options

IVICs offer a wide range of investment options. The objective of fact finding in this area is to ensure an appropriate allocation of assets to meet the client's need for growth over the long-term and access to capital in the short-term.

Many insurance companies offer asset allocation software or questionnaires to assist with this aspect of fact finding. Advisors may wish to develop a series of questions to either supplement these aids or act as an alternative to them.

Sample Questions

The following questions are not exhaustive. They are meant to stimulate effective fact finding strategies, not set out minimum areas of enquiry.

- When do you need your money?
- Are you comfortable with market fluctuations?
- If the markets go down, what size loss would make you uncomfortable?
- Can you afford to lose 30 percent of your investment?
- Do you like to make investment decisions?
- What other investments do you have?

4.2 Needs Assessment

The advisor should look for needs that can be positively addressed by one or more features of the product and for needs that would be negatively affected by product limitations.

An example of a positive need would be a conservative investor who is concerned about market volatility. All other things being equal, this is a need that is addressed by the IVIC's guarantees.

An example of a need that could be negatively affected is an individual approaching retirement who expects major expenses to arise at unpredictable times after he or she retires. All other things being equal, the effect of excess withdrawals on the GWB income stream would limit the effectiveness of this feature.

The key in both these examples is the phrase "all other things being equal." In most cases, a single need, either positive or negative, will not be determinative. For example, a GWB income stream may still be appropriate in the example cited if the individual has sufficient additional funds outside the IVIC to handle these expenses.

At this stage, the goal is to develop an inventory of client needs. This involves identifying them, quantifying them where possible, and assessing their relative importance for the client.

4.3 Recommendations and Advice

Once the client's needs have been assessed, the next step is to determine the product or products that address these needs.

For most clients, a suitable product or products will not address all needs equally effectively. Since the recommendations involve judgments about an appropriate balance, they should be accompanied with advice about needs that are not fully addressed. This type of discussion and related recommendations about product allocation are especially important in the area of income protection as single products are not generally intended to address all of a client's needs.

In discussing the recommendations with the client, it may be helpful to use the description of key features contained in the Key Facts document (a required part of the Information Folder) and relate each of the features to the identified needs.

The advisor should also discuss the costs associated with the proposed solutions and any potential limitations.

Where the advisor recommends a leveraging strategy to help the client achieve his or her goals for wealth creation, it is important to reinforce the fact that leveraging can magnify losses as well as gains. The client should be advised that a leveraged purchase involves a greater risk than a purchase using cash resources only. Any recommendations about leveraging should take into account both the client's financial resources to cover any losses that might result from the strategy and the client's tolerance for this risk.

5. OVERSIGHT

Insurers should take a risk-based approach to monitoring the sales practices of advisors selling IVICs.

There are a number of "red flags" or indices for review that insurers can use to identify situations calling for heightened monitoring or investigation. These include:

- deferred sales charges incurred due to early surrenders
- surrenders within six (6) months
- excess withdrawals
- product switches, e.g., from mutual funds to segregated funds
- movement between internal policies and/or external organizations within a short period of time, typically six (6) months, one (1) and two (2) years
- frequent transactions (excluding those in systematic plans)
- leveraging
- concentration limits
- deviations from normal sales patterns

None of these indices, by themselves, are evidence of unacceptable sales practices. Rather, they are signs that the insurer, or the person to whom oversight has been delegated, should use to heighten monitoring and perhaps question a specific recommendation.

6. CONCLUSION

Given the inherent complexity of client circumstances and the fact that alternative solutions may often be available, there is seldom a single or best recommendation that advisors can make regarding IVICs.

For this reason, it is important that advisors carefully document the fact finding and needs assessment that support the advice they provide to a client. If, at some time in the future, there are questions about the recommendation, it will generally be necessary to reconstruct the advisor's reasoning to determine whether the rationale for the advice is reasonable. As discussed in the explanatory notes that accompany *The Approach*, the appropriateness of advice and recommendations will be determined by considering the fact finding and needs assessment and whether or not these support the advisor's decisions.