

**IN THE MATTER** of the *Insurance Act*, R.S.O. 1990, c. 1.8, as amended ("the Act") by the *Financial Services Commission of Ontario Act*, 1997, S.O. 1997, c.28;

**AND IN THE MATTER** of a Prohibition Order issued by the Chief Executive Officer and Superintendent of Financial Services on September 18, 1998 regarding Transamerica Life Insurance Company of Canada pursuant to subsection 110(7) of the Act;

**AND IN THE MATTER** of an appeal in accordance with section 17 of the Act.

**BETWEEN:**

**TRANSAMERICA LIFE INSURANCE COMPANY OF CANADA**

Appellant

-and-

**SUPERINTENDENT OF FINANCIAL SERVICES**

Respondent

**BEFORE:**

Eileen E. Gillese, Chair  
Joseph Martin, Member  
C.S. (Kit) Moore, Member

**APPEARANCES:**

For the appellant:  
Mr. Paul J. Bates  
Mr. Darren J. Noseworthy

For the respondent:  
Mr. John T. Petrosniak

Hearing Date:

December 9, 1998  
North York, Ontario

Decision Released:

January 28, 1999  
North York, Ontario

## REASONS FOR DECISION

### Nature of Appeal

Transamerica Life Insurance Company of Canada (“Transamerica”) appeals from a Prohibition Order dated September 18, 1998 (“the Prohibition Order”) issued by the Superintendent of Financial Services (the “Superintendent”) which prohibited Transamerica from issuing a variable insurance contract known as “BPI Legacy Funds<sup>TM</sup> Annuity Contract” (the “Contract”). The Contract featured a negotiable initial sales charge option which permitted an insured to negotiate an initial sales charge with a distributor up to a maximum charge established by Transamerica.

Pursuant to section 110(7) of the Act, the Superintendent issued the Prohibition Order on the grounds that the Contract would enable insureds to negotiate commissions and, thus, the Contract would create the possibility that persons in the same class and with the same expectation of life would pay different premiums for the same amount of insurance or purchase different amounts of insurance for the same premium. The Superintendent found that this would amount to “unfair discrimination between individuals of the same class and of the same expectation of life in the amount or payment of premiums” and, therefore, the Contract was seen to fall within the definition of “unfair or deceptive acts or practices” set out in subsection 438(b) of the Act and prohibited by section 439 of the Act.

Transamerica asks the Financial Services Tribunal (“the Tribunal”) to allow the appeal and

quash the Prohibition Order of the Superintendent with costs.

### **The Contract**

A variable insurance contract consists of a written agreement governing an insured's participation in a fund. The monies in the fund may be allocated to acquire notional units in one or more segregated funds. Each fund invests all of its net assets in a corresponding conventional open-ended mutual fund, in this case managed by the BPI Capital Management corporation. The assets of the funds are owned by Transamerica and segregated from its other assets. At the relevant time, there were 11 such funds.

Under the terms of the Contract, an insured may make deposits using one of the following two options: (i) Deferred Sales Charge Option or (ii) Initial Sales Charge Option.

If an insured selects the Deferred Sales Charge Option, the full amount of his or her deposit is allocated to the Contract, and Transamerica pays a 5% commission to the distributor. This option requires an insured to maintain his or her investment in the Contract for a minimum 6 year term, failing which, he or she will be subject to a surrender charge at a rate stipulated in the Contract.

If the Initial Sales Charge Option is selected, the sales charge negotiated by the insured is deducted from the amount received for deposit and paid to the distributor by Transamerica on the insured's behalf. This option permits an insured to negotiate an initial sales charge and enables the insured to transfer his or her investment at any time without incurring any surrender charges.

Transamerica has established maximum initial sales charges for stipulated bands of investment.

Transamerica argues that the negotiable feature of the initial sales charge option will provide insureds with the benefit of flexibility and that the express maximum initial sale charges provides adequate protection. Transamerica anticipates that an insured who deposits larger sums will negotiate reduced initial sales charges, as compared with insureds depositing lesser sums. Transamerica also anticipates that an insured's choice concerning the amount of initial sales charge to be paid will be determined by factors idiosyncratic to the individual insured-- e.g. whether the Contract was registered as part of his or her RSP, the level of liquidity required with respect to termination and transfer of deposits, and other factors relevant to individual insured preferences. The amount of the initial sales charge paid by insureds would not, in all cases, be a function of the amount of their initial deposit.

Transamerica also argues that it is necessary to offer an initial sales charge option to facilitate distribution and consumer recognition of the Contract because the Contract would be distributed, in part, by agents holding a dual licence under provincial insurance and securities legislation. As a result, potential consumers could purchase variable insurance contracts or mutual funds from the same distributor. Harmonizing initial sales charge structures with competing mutual fund products should allow for an easier comparison of the two products by the consumer.

### **The Decision of the Superintendent**

In December of 1997, Transamerica filed the Information Folder for the Contract with the (then) Ontario Insurance Commission and concurrently with insurance regulators in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland, the Yukon Territory and the Northwest Territories. Pursuant to section 3.8 of the CLHIA Guidelines on Individual Variable Insurance Contracts relating to segregated funds adopted by regulations in each province<sup>1</sup>, the insurance regulators were to review the documents for compliance with applicable provincial insurance laws and provide a receipt within 30 days. Transamerica's Contract was approved without restriction by insurance regulators in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland, the Yukon Territory and the Northwest Territories.

Ontario's former Acting Superintendent of Insurance (the "Acting Superintendent") issued a conditional receipt to Transamerica for the Contract, with the following limitation:

This receipt is issued subject to the condition that no contracts will be sold in Ontario under the Initial Sales Charge Option until such time as the Ontario Insurance Commission approves such sales.

The Acting Superintendent issued an updated conditional receipt to Transamerica setting out the following three conditions:

---

<sup>1</sup> *O.Reg. 132/97*

- (I) Transamerica will treat sales charges under the Initial Sales Charge Option as not being negotiable between an applicant/contract-holder and a Distributor until such time as a court or regulatory authority having jurisdiction in Ontario interprets section 439 of the *Insurance Act*, R.S.O. 1990, c.I.8 as not being a bar to negotiable front-end loads in respect of individual variable insurance contracts;
- (ii) The maximum sales charge for all funds (except the BPI T-Bill Segregated Fund) is 5% of the total amount received (or 5.26% of the net amount received). For the BPI T-Bill Segregated Fund, the maximum sales charge is 2% of the total amount received (or 2.04% of the net amount received);
- (iii) Transamerica may, at any time and from time to time, fix such sales charges within such minimum and maximum limits, but the sales charges so fixed at any time must be uniform across Ontario.

Transamerica appealed from the decision of the Acting Superintendent to the Commissioner of Insurance, asking that the conditions be removed. The appeal was framed as a request to provide an unconditional receipt by the Commissioner of Insurance, as an exercise of her original jurisdiction arising effective July 1, 1998 as Superintendent of Financial Services or, alternatively, as an exercise of her appellate jurisdiction as Commissioner of Insurance.

The Superintendent exercised her original jurisdiction under section 110 of the Act to provide an unconditional receipt to Transamerica for the Contract and contemporaneously issued the Prohibition Order with respect to the Contract in the following terms:

The specific concern in this case is that an insurer that offers negotiable commissions will unfairly discriminate between individuals of the same class and of the same expectation of life by charging premiums that are not the same for one person as another in the same class. Persons of the same class are entitled to be certain in knowing that the amounts they pay in commissions are the same as others in that same class. Their respective abilities in negotiation or knowledge of negotiation opportunities

does nothing to ensure competitiveness in the marketplace nor instill greater consumer confidence in the life insurance industry.

**Pursuant to section 110(7) of the *Insurance Act*, I hereby order that Transamerica not issue any variable insurance contracts under the name BPI Legacy Funds Annuity Contracts where a negotiable commission is offered to potential policyholders.**

Letters exchanged between Transamerica's solicitors and the solicitors for the Superintendent made it clear that the Superintendent based her decision to issue the Prohibition Order on subsection 438(b) of the Act and the materials filed by Transamerica on the appeal.

### **The Procedure on Appeal**

This is the first case to be heard by the Tribunal and certain procedural issues arose. It may be helpful to outline the views of the Tribunal on those matters. At the pre-hearing conference, counsel for the Superintendent urged the Chair to treat this appeal as a hearing de novo so that the Tribunal would treat it as a matter at first instance. He sought to call witnesses and introduce evidence that had not been heard by the Superintendent and which, obviously, Transamerica had had no opportunity to respond to. In determining how the matter would proceed, the Chair ruled that it would be treated as an appeal.

The Tribunal begins by noting that, in this case, a decision was rendered by the Superintendent from which an appeal was taken. The procedures to be followed in hearing an appeal are generally

markedly different than those in hearing a matter at first instance. This matter is brought pursuant to s.17 which expressly identifies it as an appeal.

**S.17** (1) If an appeal is provided for, a person affected by a decision of the Superintendent may appeal the decision to the Tribunal. ...

(3) The Tribunal shall hold a hearing of an appeal.

(5) Upon hearing an appeal, the Tribunal may, by order, confirm, vary or rescind the decision appealed from or substitute its decision for that of the Superintendent.

The appeal provision in s. 17 is in direct contrast with other provisions in the legislation that relate to the role of the Tribunal if the Superintendent acts through the issuance of a Notice of Proposal. In other words, the Act sets up two different schemes of decision making. In one scheme, the Superintendent does not actually make a decision but, rather, alerts a party that she intends to make a decision through the issuance of a Notice of Proposal. If an affected party wishes to contest the matter, the Tribunal is called upon to hold a hearing. It is very likely that, in such cases, the Tribunal will hold a hearing and treat the matter as one of first instance. No decision has actually been rendered by the Superintendent in such cases, thus, the Tribunal becomes the first instance decision maker and must adopt procedures appropriate to first instance decision making.

In other situations, such as the matter before us, the Act calls upon the Superintendent to make a decision. Once the decision is made, the Act provides an affected party with a right of appeal. The Tribunal is then called upon to act in an appellate capacity, not as a decision maker at first instance. Accordingly, the procedures adopted will be those appropriate to an appeal.

It would make a mockery of the decision making processes of the Superintendent if the Tribunal were to begin afresh to hear evidence in the case at hand. We understand the intent of the legislation, as expressed in section 17, to be that the Superintendent is to make her decision and the Tribunal is to consider the decision and the materials upon which she based her decision to determine whether to confirm, vary or rescind the decision. In coming to this view of our processes, we have relied upon the plain meaning of the word “appeal” in the section and the fact that the legislation provides for a different process when the Superintendent issues a Notice of Proposal. Moreover, if the Tribunal were to decide this type of matter afresh, it could undermine the operation of the Commission. Parties would either view decision making by the Superintendent as superfluous and, therefore, spend little time in presenting their cases to the Superintendent or parties would diligently prepare both for a first instance hearing before the Superintendent and again for a first instance hearing before the Tribunal, thereby leading to additional costs and delays and a needless duplication of effort as full inquiry would be made at both levels.

By following the wording of the legislation and treating the matter as an appeal, we believe our processes are appropriate, fair and efficient and show a proper regard for the role and decision making authority of the Superintendent.

### **The Relevant Legislation**

**S.110 (1) Definition of variable insurance contracts.** -- In this section, “variable insurance contract” means an annuity or life insurance contract for which the reserves or a part thereof vary in amount with the market value of a specified group of assets held in a separate and distinct fund and includes a provision in a life insurance contract under which policy dividends or policy proceeds may be retained for investment in such a fund.

(2) **Prohibition.** -- No insurer shall issue a variable insurance contract or offer to enter into a variable insurance contract that under this Act would be deemed to be made in Ontario until there has been filed with the Superintendent a specimen form of such variable insurance contract, an information folder pertaining thereto and such other material as may be required under the regulations and a receipt therefor has been obtained from the Superintendent.

(3) **Form of contract.** -- The forms of variable insurance contracts and information folders with respect thereto shall comply with the requirements of Part V of this Act and the regulations.

(4) **Form of information folder.**-- The information folder shall provide brief and plain disclosure of all material facts relating to the variable insurance contract and shall contain a certificate to that effect signed by the chief executive officer and the chief financial officer of the insurer or such other persons as the regulations may prescribe.

(5) **Delivery of information folder.** -- No application for a variable insurance contract shall be accepted by an insurer until the insurer has delivered to the applicant therefor a copy of the latest information folder relating thereto that is on file with the Superintendent.

(6) **New information folders.**-- So long as an insurer continues to issue a variable insurance contract in respect of which it has filed an information folder, it shall,

- (a) forthwith after the occurrence of any material change in the contract or in any other facts set out in the latest information folder so filed; and
- (b) within thirteen months after the date of filing of the latest information folder so filed, or such other period of time as may be provided by the regulations,

file with the Superintendent a new information folder in respect thereof.

(7) **Prohibition order.**-- Where it appears to the Superintendent that,

- (a) an information folder or any other document filed with the Superintendent by an insurer with respect to a variable insurance contract,

- (i) fails to comply with any substantial respect with the requirements of this Act or

the regulations,

- (ii) contains any promise, estimate, illustration or forecast that is misleading, false or deceptive, or
  - (iii) conceals or omits to state any material fact necessary in order to make any statement contained therein not misleading in the light of the circumstances in which it was made; or
- (b) the financial condition of the insurer or its method of operation in connection with the issuance of its variable insurance contracts will not afford sufficient protection to prospective purchasers of such variable insurance contracts in Ontario,

the Superintendent may prohibit the insurer from continuing to issue such variable insurance contracts in Ontario.

**438. Definitions.**--For the purposes of this Part, ...

“unfair or deceptive acts or practices” includes, ...

- (b) any unfair discrimination between individuals of the same class and of the same expectation of life, in the amount or payment or return of premiums, or rates charged by it for contracts of life insurance or annuity contracts, or in the dividends or other benefits payable thereon or in the terms of conditions thereof,

**439. Prohibition.**--No person shall engage in any unfair or deceptive act or practice.

## **The Issues**

A number of issues were raised by the parties. The Tribunal is of the view that the two that are central to resolution of this appeal are as follows.

Does the negotiable initial sales charge of the BPI Legacy Funds<sup>TM</sup> Annuity Contract constitute “discrimination”, within the meaning of subsection 438(b) of the Act, against “...individuals of the same class and of the same expectation of life...”?

If so, is that discrimination “unfair” within the meaning of subsection 438(b) of the Act so as to constitute an “unfair or deceptive act or practice” under section 439?

The two issues are so intertwined that they are discussed together.

“Discrimination” is not defined in the Act. We generally think of discrimination as some type of act by an insurer which treats people of the same class and expectation of life differently. In this case, Transamerica does not treat people differently, as the initial sales charge is to be negotiated by the insured with the distributor within a maximum limit stipulated by Transamerica. That is, it is not the act of Transamerica which is discriminatory. If discrimination takes place in the sense described above (ie. people of the same class and expectation of life being treated differently), it is a function of the choice of

the insured.

Does the potential for uneven treatment, albeit arising from the choice of the insured, mean that the Contract is discriminatory? On one view, the benefits of flexibility and choice offered by the initial sales charge option are the antithesis of discrimination. This view is based on the notion that discrimination arises when a prejudice or burden is imposed by a party upon persons of the same class and expectations of life. On the opposing view, discrimination occurs when persons of the same class and expectation of life are treated differently, even if the individuals have been involved in, and made choices about, the process that led to them being treated differently.

Insureds who select the initial sales charge option will be varied and will seldom have common characteristics with regard to class and expectation of life. Insureds cannot be said to be of the same class where the services received are different or the value of insurance purchased is different. Differences in negotiated initial sales charges will generally result from individual choice, which may be influenced by the value of the services provided by distributors, as well as other unique circumstances pertaining to the investment portfolio of each insured. Insureds will not necessarily place the same value on their distributor's services, even if they deposit the same total consideration under their contracts. One insured may be supplementing an existing fund balance, while another may be making an initial deposit. There can be no discrimination in those circumstances.

There was no evidence before the Superintendent to suggest that there would be many, if any, insureds with the same personal characteristics and the same service needs, the same amount of total investments and the like. Unless all those factors are identical, they will not be of the same class and expectation of life and therefore there is no discrimination. Even if they are of the same class and expectation of life, there is no evidence to suggest they will be unable or incapable of negotiating the same initial service charge. The Prohibition Order compels a fixed premium payable by insureds whose differences will exceed their common characteristics. Such an order appears to be overreaching.

Alternatively, we find that the initial sales charge option is not unfair discrimination because the amount of the initial sales charge payable by an insured will depend upon his or her choices having regard to personal considerations pertaining to the value of the distributor's services. The amount negotiated is not an imposed element of the Contract but results from choice in a market in which consumers can benefit from competition between variable insurance contracts and mutual funds products.

Subsection 110(7) of the Act stipulates that the Superintendent *may* issue a Prohibition Order in circumstances where the Contract or Information Folder "...fails to comply in any *substantial respect* with the requirements of the [Act]". Clearly, the Superintendent was not obliged to issue the Prohibition Order; it was the exercise of a discretion. We are not convinced that it was correctly exercised in that the potential may not amount to a failure to comply in a "substantial respect". In any event, we find the Prohibition Order to be a disproportionate response in that it inflicts a major

consequence on Transamerica, harm that is disproportionate to any public benefit it may confer. The Prohibition Order was issued by the Superintendent based upon speculative concerns regarding hypothetical harm to a small and unidentified number of potential users. In such circumstances, any theoretical and speculative harm that might be caused by allowing negotiable initial sales charges in variable insurance contracts is outweighed by the potential public benefit the Contract creates.

The public is not left unprotected by our decision as the Superintendent holds the power to issue a Cease and Desist Order pursuant to s. 441 of the Act. If the potential harm was found to be widespread, a Prohibition Order might be more effective. Given the extremely limited number of situations in which harm can arise, the directed approach of s. 441 appears to offer any protection that is needed.

It is vital, however, that Transamerica make full disclosure of the fact that the initial sales charges are negotiable. As it stands, that fact is buried in fine print many pages into a detailed contract. Consumers need to be made aware of the fact that the initial sales charge is negotiable and this fact needs to be communicated clearly and boldly on the first page of the contract and other documentation and preferably, a sign to that effect would be posted in the office of any agent who offers the product. The Superintendent should take whatever steps are necessary to ensure that full disclosure is made.

## **CONCLUSION**

For these reasons, the appeal is allowed and the Prohibition Order of the Superintendent is

quashed. No order as to costs shall go.

Dated this 28th day of January, 1999 at the City of North York, Province of Ontario.

“Eileen E. Gillese”  
Eileen E. Gillese, Chair

“Joseph Martin”  
Joseph Martin, Member

“C.S. (Kit) Moore”  
C.S. (Kit) Moore, Member