

INSURANCE COUNCIL OF BRITISH COLUMBIA

DUTIES AND RESPONSIBILITIES OF LIFE INSURANCE AGENTS INVOLVED IN THE SALE OF EXEMPT MARKET SECURITIES

An exempt market security (sometimes known as an “alternative investment”) is an investment vehicle and although it is a security as defined by the *Securities Act*, it does not require that the seller hold a securities registration in British Columbia. These products are not life insurance products, but can be sold by life insurance agents (“life agent”) and are becoming an increasingly popular investment recommendation that life agents make to clients.

While the distribution of these investments is subject to regulatory oversight by Canadian securities regulators, the Insurance Council of British Columbia (“Council”) has concerns when these investments are sold by life agents. More specifically, Council is concerned with life agents that do not hold a securities registration but engage in the sale of exempt market securities. For life agents that hold a securities registration, their activities are monitored by their securities or mutual fund dealer.

A recent example highlights Council’s concerns. Based on the recommendation of an experienced life agent, a retired client of modest resources and limited income moved a portion of her retirement portfolio, that was invested relatively conservatively and which contained some guarantees, to an exempt market security. The investment turned out to be a scam and, although the life agent was duped himself, he should never have recommended the investment to his client, who lost money she could not afford to lose. Council found the life agent had set out on an irresponsible course of conduct that was incongruent with the interests of his client. As a result, Council found the life agent’s actions made him unsuitable to hold a licence and cancelled his life insurance licence for a minimum period of two years.

In light of this situation and others recently reviewed, Council has identified risks and concerns that can arise when life agents decide to promote and sell exempt market securities. Set out below are a number of guidelines that life agents, who do not hold a securities registration, should follow when marketing exempt market securities to their clients:

- **Holding Out**: clients often consider their life agent to be their financial advisor and, therefore, knowledgeable about all financial products, not just insurance. Consequently, a client may presume that when a life agent recommends an exempt market security the recommendation is based on the life agent’s knowledge and experience. Without sufficient disclosure, a client may falsely believe that a life agent’s licence qualifies the life agent to sell an exempt market security or that the life agent’s licence validates the sale of such products, which is not the case. A life insurance agent who does not hold a securities registration should, prior to engaging in the sale of exempt market securities, provide written disclosure to the client explaining:
 - ✓ his/her qualifications and experience relating to exempt market securities;
 - ✓ how funds are to be handled;
 - ✓ the risks relating to these products; and
 - ✓ the fact they are not regulated.

- Unsuitable Transactions: a life agent has a responsibility to understand all aspects of the exempt market security that he/she is recommending to a client. When a recommendation is made, the life agent must be able to demonstrate that the recommendation is consistent with the client's financial knowledge and risk tolerance; and
- Separation of Business: clients need to understand that their funds are not "protected", as they would be if it were an insurance transaction. A life agent must keep exempt market security business separate from his/her insurance practice and should disclose to the client how funds will be handled.

Life agents have a duty to exercise due care and attention when engaging in the sale of exempt market securities. Failure to exercise due care or to follow the above guidelines when recommending exempt market securities can bring into question a life agent's competency and suitability to hold a life agent's licence.

Life agents who sell exempt market securities must be aware of all the requirements set out under the *Securities Act*, regardless of whether they are selling these investments to insurance clients or others. Any contravention of securities legislation will also reflect on a life agent's suitability.

If you have any questions regarding this Notice, please contact Regulatory Services by calling Council's main number and at the prompt press "2".

July 4, 2011
ICN #11-003