Independent Financial Brokers of Canada (IFB)

IFB Comments on Issues Paper - Managing General Agencies: Life Insurance Distribution Model

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IFB Comments on the CCIR Issues Paper

Managing General Agencies: Life Insurance Distribution Model

Introduction

Independent Financial Brokers of Canada (IFB) welcomes the opportunity to assist the Canadian Council of Insurance Regulators (CCIR) in furthering the understanding of the current distribution of life insurance products to Canadian consumers. We appreciate the ongoing dialogue insurance regulators engage in with industry stakeholders and their commitment to principles based regulation. We believe that this interchange of knowledge and discussion lends itself to establishing smart regulation, rather than leading to over-regulation of the marketplace.

Independent Financial Brokers of Canada

IFB is a professional trade association whose members are located across Canada and are licensed to provide financial advice and products to clients. Many of our members are licensed or hold the professional designations necessary to provide complementary financial services, in addition to life insurance. For example, many would also be securities/mutual fund registrants, financial planners, mortgage brokers or P&C brokers. However, for the purposes of responding to this Issues Paper, our remarks will focus on the distribution of individual life insurance.

It is important to note that IFB membership is restricted to brokers who operate as independent contractors. That is, they are self employed, often sole proprietors or owner operators of their business. They have chosen this business model because they believe strongly that their ability to access products from a variety of insurers means they can provide their clients with the most suitable product to meet that client's needs.

IFB traces its roots to over 25 years ago when a handful of former career agents joined together to advocate for more product choice for their clients. Today, the independent channel is well-established and the largest deliverer of insurance.

Life Insurance

Life insurance is an essential product in the financial toolbox. It is unique from most other financial products in that it is generally a long term purchase intended to provide financial security in the event of death, disability or long-term illness. While it may contain an investment element, it is not bought and sold like other financial investment products.

Providing clients with life insurance advice and products is a major part of what our members do. These products have become increasingly complex and the choices available to clients often require the attention of a professional, knowledgeable, caring broker who spends the time to research the various alternatives available so that the product chosen reflects the needs of that individual, his/her family or business.

Life insurance sales take place in a competitive environment where consumers are free to choose services and/or products from an independent representative, an employee of an insurance company or over the internet. We believe that the range of choices available to the public enhances consumer protection.

Variability of arrangements as an Issue

A central issue raised in the paper is the wide variance in the level and types of services MGAs provide to brokers and insurers. MGAs do vary greatly in their size and organizational complexity. Some function as sister companies to a mutual fund or securities dealer and have in-house compliance personnel. Others will be stand-alone insurance only entities, which exist solely to provide administrative convenience for the insurers and brokers who do business with them. The fact that differences such as these exist is a reflection of the needs of the marketplace and perhaps even the local community they are situated in. The arrangements they share in common, though, are the contractual relationships, which set out the expectations of each party - these parties being the MGA and insurer, insurer and broker, and broker and MGA.

We are not aware that because there is not a standard MGA contract, that this has led to problems for consumers. However, if regulators wish to address some of this variability they may consider harmonizing certain requirements, already in place in some provinces, such as requiring a separate licensing category for MGAs/AGAs, and setting some minimum practice standards, including the requirement for E&O insurance.

Supervision as an Issue

Supervision, and the responsibility of each of the parties (i.e. the insurer, MGA and broker) with regard to market oversight of the sale of insurance, is another issue of concern raised in this paper. Historically, agents were supervised by a single company through branch offices. In today's market, an independent broker can have arrangements with many insurers and place business with one or more MGAs. In our view, this is appropriate and should not be construed as leading to a lower level of supervision or reducing consumer protection.

Regulators have established entry criteria (e.g., completion of the LLQP, good character, minimum education, etc.) and ongoing licensing requirements to filter unsuitable representatives. Many provinces have initial and ongoing sponsorship requirements in order for a broker to be licensed. In addition, regulators have the power to suspend or terminate a license. In a competitive marketplace, brokers can choose the insurance companies and MGAs that they wish to place business with. Similarly, insurance companies and MGAs can choose not to contract with a particular broker.

However, to address some of the supervisory issues and assist with due diligence, regulators may wish to establish a centralized registry where consumers, insurers, agencies and others could easily access information when enforcement action has been taken against an agency, broker/agent and insurer in any provincial/territorial jurisdiction.

IFB Survey
In order to accurately reflect the business arrangements that exist between independent brokers, MGAs or AGAs, insurance companies and ultimately consumers, IFB prepared an on-line survey, using Survey Monkey. The survey results reflected below are based on information gathered between March 3 and March 31, 2011, although the survey remains open and continues to attract respondents.

You may recall we did a similar survey in preparation for our previous submission to the CCIR in 2009. That survey attracted 400 respondents which was a significant number. In contrast, the 2011 survey has attracted over 800 respondents. This demonstrates to us that the questions being asked by regulators about the distribution model, and in particular the role of MGAs, is of major interest to brokers and agencies alike!

The survey asked participants to identify themselves as primarily an independent life insurance broker or a principle of an AGA or MGA. Approximately 700 independent brokers responded and 100 representatives of agencies. Their survey answers were sorted by these two categories.

Summary of Broker Data

- Most respondents (400)live in Ontario; 200 reside in the West and the remainder reside in Quebec and the Maritime provinces
- Most brokers are licensed in multiple jurisdictions
- 80% have been licensed for more than 10 years
- Most have contracts with at least 3 insurers
- Most place business through a MGA. Many also have contracts which allow them to place business directly with an insurance company. A much smaller number have AGA contracts.
- Most use 1 MGA, although a significant number said they deal with more than 5
- Most said the primary reason for doing business with a particular MGA is the level of service provided. The second most important reason is the insurers the MGA has contracts with.

Summary of Agency Data

- The majority have their head office located in Ontario (55), 19 are in the Western Provinces, 4 in Quebec and the remainder in the Maritime provinces
- Most are licensed in a variety of provinces
- 66% were not affiliated with a mutual fund dealer, 33% were
- 30% have less than 10 brokers under contract; 24% have between 10-99 brokers; 26% have between 100-500 brokers and 10% have more than 1,000 brokers
- 90% carry separate corporate E&O insurance

Questions to Stakeholders
IFB will address many of the 26 questions posed in the Issues Paper. However, since some are quite specific to insurers and their relationships with MGAs, we will leave those to be commented on by stakeholders who have a more direct knowledge of these arrangements.

1. Are there other aspects of AGAs that differentiate them from MGAs?
2. Which functions of MGAs do not apply to AGAs? Are the activities of AGAs closer to representatives rather than MGAs?
   We have grouped our responses to questions 1 and 2 below.

The arrangements between an insurer and individual MGA/AGAs vary significantly so we cannot provide a definitive answer to these questions. However, it would generally be true that a MGA provides a more comprehensive suite of services than an AGA, as described below. In addition, AGAs tend to be smaller and often contract with an insurer through a MGA. This would be the case, for example, where pooling the business allows them access to an insurer that the AGA does not have a direct contract with.

To better understand how brokers access the various services they need and where they are most likely to obtain those services, we asked them to describe the services they are most likely to obtain from their MGA, AGA, insurance company or provide for themselves.

Brokers said they were most likely to obtain these services from a MGA. The most common services they get from their MGA(s) are: Bonusing, CE and product training, back office support, policy tracking, electronic processing, product consultation and compliance support.

A much lower number indicated they get these services directly from the insurance company. Those that do said the most common are: product training, product consultation, conferences, CE and training.

A very small number (less than 30) indicated they get some of these services from their AGA. Those who do said their AGA provides: product training, product consultation, CE, bonusing and compliance advice.

When we asked brokers what services they are most likely to acquire for themselves, they said: provision of office space, business branding, succession planning and CE.

Functions Outsourced to MGAs

3. What are the factors considered by an insurer before deciding whether or not to outsource an activity to an MGA?
This question is better addressed by other stakeholders.

4. How do insurers satisfy themselves that MGAs have the expertise to carry on the delegated functions (e.g. product training, product development, etc.)?
We would expect that insurers would provide guidance and undertake periodic audits of the MGA to ensure that it is fulfilling its delegated functions. These would be common business practices to control risks, not unique to this arrangement.

   In addition, insurers themselves conduct training sessions for brokers and staff of MGAs/AGAs on new and existing products, regulations and procedures. For the insurer, this helps ensure that MGA staff has the knowledge to assist brokers with questions related to their products.

5. Are there functions that should not be outsourced to an MGA (e.g. core functions such as underwriting and claims handling*)?* Would delegating to MGAs a function such as product development affect the insurer's role as manufacturer?
We are not aware of any insurers which have outsourced functions such as underwriting and claims handling. In our opinion, this is – and should remain - the responsibility of the insurance company.

6. Do insurers view functions outsourced to an MGA/AGA as material to their risk management process?
   This question is better addressed by other stakeholders.

7. How should insurers be held accountable for the activities outsourced to MGAs? Is having appropriate safeguards and conducting regular assessment of whether the MGA is achieving the right standards for each delegated function sufficient? Or would insurers also take responsibility for the mistakes of the MGA?
   Insurers and MGAs are better able to comment on this question. However, we would expect that insurers would undertake specific and regular activities to examine MGA practices to reduce the insurer's exposure to business and reputational risk.

8. What can be done to enhance compliance monitoring of functions outsourced to MGAs? Would standardized compliance monitoring guidelines assist smaller insurers?
   We are aware that CAILBA is developing a 'compliance toolbox' to assist its members and that the CLHIA in conjunction with CAILBA developed a MGA compliance questionnaire to assist in the development of more standardized processes.

   It is more appropriate for those organizations to expand upon these initiatives in their responses to this Issues Paper.

Supervision of Representatives

9. What specific activities do insurers carry on today in supervising representatives and reporting misconduct?
   There are guidelines (e.g. CLHIA G8) for insurers to follow and which are broadly accepted within the industry. All brokers have contracts with insurers and the insurer has a statutory obligation to supervise its representatives and report misconduct to regulators.

   Our survey showed that both MGAs and insurers require brokers to provide proof of compliance. The most common compliance requirements were: proof of license renewal and errors and omissions insurance coverage. Other frequently cited requirements were proof of: conflict of interest disclosure, privacy compliance, anti-money laundering processes and client needs assessment.

10. Under today's MGA structure, has detection and reporting of "unsuitable representatives" become more difficult as a representative is, at any given moment, dealing with various MGAs and insurers? Please elaborate.
    We do not think that the MGA structure contributes to reduced detection or reporting of "unsuitable representatives". The underlying assumption seems to be that the level of detection and reporting was superior under the former career agency structure. The nature of this business is that it is trust-based and reliant on all parties to conduct themselves in an ethical and professional manner. Branch managers of career agencies cannot be in every prospective client's home or sit in on every client meeting anymore than staff of MGAs or insurers can. Indeed, an argument could be made that with more 'eyes' on the independent broker there is less opportunity for unsuitable representatives to go undetected.

In addition, regulators have requirements intended to bolster the suitability of those entering the profession, have set minimum licensing standards, and ongoing requirements to ensure life agents and brokers maintain a defined level of professionalism.

Restricting a broker to a single MGA or insurer would negatively affect consumer choice and the industry. The advantage of today's marketplace for consumers is that an independent broker can search the market for the best price and product, from a variety of insurers, to meet that client's needs. One has only to look to the creation of the MFDA, and the dramatic impact it has had on reducing the number of independent mutual fund dealers, for proof of the consequences of mandating compliance oversight with a single dealer. In addition, while some MGAs may support the simplicity, convenience and increased revenues of having their brokers restricted to placing all their business with their agency, a reduction in accessing independent advice for consumers would be a certain outcome.

11. Is it necessary that some party be in a position to monitor the overall business practices of a representative? If no, why not? If yes, which party, MGA or insurer, is in the best position to do that monitoring?
Under the present system, both the insurer and MGA have a role in monitoring the activities of the broker, at least insofar as it relates to business written through that insurer or agency. As a consequence, this means that more than one party has a role in monitoring the appropriateness of the transaction, which is better for the client. However, the use of the word 'overall' in this question suggests that independent brokers should be accountable to and supervised by a single party, which we would not support. Brokers are accountable for each piece of business they write. This accountability extends to the client, MGA, insurance company and, ultimately, their regulator.

Also, as previously noted, all individual life insurance is not sold through independent brokers. A significant portion is sold through career agents and direct writers which may on the surface appear to operate in a more controlled environment but, in the end, still rely on the individual advisor's commitment to trust and honesty.

Associations (like IFB), insurance companies and regulators each have established market conduct and professional standards. In addition, representatives of insurers operate under individual contract which can be terminated if the representative is found to be unsuitable.

12. Given their proximity and close relationship to representatives, should MGAs be responsible for reporting questionable acts by representatives:
a. to insurers with whom they have an agreement?
b. to insurance regulators?

'Questionable' acts, upon further examination, may not be found to be unsuitable acts or contravene any regulations. Therefore, we would expect a significant degree of caution to be exercised before a broker is reported to the insurer or regulator, as it could result in a reputational loss for the broker if wrongly accused. We have heard of situations where a MGA has treated a broker unfairly, resulting in a loss of reputation and, consequently, business for the broker. However, insurers and MGAs have contracts which would detail the MGAs responsibilities in reporting a broker. In our survey, approximately 70% of agency principals said reporting of unsuitable brokers was a contractual obligation. We would expect then that the insurer, as the party responsible for the suitability of its representatives, would conduct a proper investigation, and if warranted report any unsuitable representatives or misconduct to the regulator.

We asked agency principals to rate the importance of the activities their MGAs provide in the sale of insurance. In order of frequency they rated the following activities as most important: administrative co-ordination between the broker and insurer; compliance support for the insurer (i.e. broker is properly licensed, has E&O, CE, and privacy and AML procedures in place); co-ordination of commissions and bonuses; reporting unsuitable agents or misconduct and supervising the broker's sales practices. This likely reflects the differences in the types of contracts various sized insurers have with various sized MGAs, i.e. that the larger MGAs may have more functions identified in their contracts than a smaller one.

We also asked agency principals if they were satisfied with their current ability to monitor the activities of their brokers. 75% said they were very satisfied or satisfied; only 5% said they were somewhat dissatisfied and no one reported being very dissatisfied; the remainder had no opinion.

We think it would be helpful if regulators provided information on complaints against MGAs and insurers so that it is available to brokers and the public. For example, while there is a complaint reporting database for insurers, it is not publicly available. We suggest that making this information available, in a format similar to that which identifies brokers who have been subject to discipline, would be a useful consumer protection tool.

13. How is misconduct reporting handled when the representative is dually licensed? Should misconduct in one sector be reported in the other sectors where the representative is licensed? Our members who are dual licensed are generally licensed for mutual funds and life insurance. MFDA Policy 6, Section 4, specifies the complaint handling procedures for the representative to report to the Dealer and requires reporting complaints or regulatory action arising from any regulator. It requires that "Approved Person reporting includes reportable events related to securities related business, Member business *and all other business conducted by the Approved Person* (emphasis added)*."* We objected to the extent of this reporting because complaints may be without merit and relate to a broker's business which is not under the mandate of the MFDA, its Member dealers, or securities regulators.

    Having said this, evidence of misconduct is a different matter. Information on representatives who have been disciplined or sanctioned by securities regulators and/or insurance regulators is in the public domain, as it should be.

    We note that Canadian securities regulators and SROs have recently implemented a centralized link for investors and others wishing to search the enforcement history of securities licensed advisors. Insurance regulators may wish to examine establishing a similar, centralized database for the convenience of consumers, MGAs and insurers, as an aid in conducting their due diligence.

Managing Conflicts of Interest

14. To what extent can or does an MGA influence the decisions of its representatives to place insurance with one insurer over another? How is this controlled?
    We asked brokers in our survey if their MGA influences which insurer they do business with. An over whelming 78% of respondents said no. Only 6% said they did.

    We asked those who felt MGAs exert some influence to explain in greater detail. The majority of their comments revealed it is the experience and knowledge that many MGAs offer, in helping them find the right policy for their client, which contributes to placing insurance with a particular insurer. Below is a sample of their explanations:
    - *The MGA provides insight into which insurer might be more inclined to underwrite a client whose application has been denied.*
    - *I am new and always looking for the best fit for my client. The MGA helps by giving me a few companies to research.*
    - *I appreciate their assistance with underwriting, making me aware of special product features or price, resolving placement issues and obtaining information on in-force policies.*
    - *If the client has a medical condition, the MGA can suggest companies whose underwriters may be friendlier to accepting an applicant with this condition.*
    - *MGA staff has experience and knowledge of product differences, claims reputation and price differences of various insurers. It is access to this broad experience that is the primary reason for using an MGA.*

15. Given that MGAs receive a commission from insurers for volume of business generated through the representative, what kind of disclosure to consumers (regarding this specific commission) is provided today by the representative? By the insurer?
    Industry associations worked with the CCIR Industry Practices Review Committee in 2005 to develop a conflict of interest disclosure document. IFB has a template on its website for brokers to download and customize. The disclosure document is completed by the broker, explained to the client, signed by both the client and advisor and evidence of such is submitted to the insurer with the application. One of the elements of disclosure contained in that form is that, where the broker places business through a MGA, there may be commission or other form of compensation (e.g. override) paid. This supplements the requirement in Ontario, under Regulation 347 of the *Insurance Act,* that requires agents/brokers to provide written disclosure of any actual or potential conflicts of interest to the consumer.

    The IPRC, in its review of potential conflicts of interest in the sale of life insurance, endorsed the view that the basis for any sale is product suitability and this rests with the broker:
    "It can be argued that where a broker or agent can demonstrate that an insurance product sold is suitable and price-competitive, than any conflict of interest resulting from compensation, ownership or financial links is adequately managed. The IPRC believes that potential conflicts of interest that may arise through these incentives and financial arrangements can be managed in a way that is practical, economically sensible, and reflective of best practices."

16. What are the expectations of insurers when supervision of sales practices is delegated to MGAs? Is oversight limited to completeness (form) as opposed to the nature of the advice (substance)?
    Most of the brokers and agency principals who responded to our survey indicated that the service provided by the MGA is most often related to the completeness of the application. Far

fewer said the MGA reviews the suitability of the broker's advice, although as stated previously, the MGA will often require the broker to provide proof of certain compliance processes.

Under the current system, the broker is responsible for establishing the needs of the client and the suitability of the product. Our members strongly believe that this is appropriate and their role in assisting their clients.

Role of MGAs in Sales Transactions and Handling of Consumer Complaints

17. What problems have arisen to date regarding transaction errors involving MGAs and how have they been resolved? How do consumers know who to go to in these situations?
    The broker is the primary point of contact for their clients. If a mistake was discovered that affected the client, the broker would advocate for the client with the MGA or insurer to ensure the mistake is corrected.

    The requirement for a MGA to have separate corporate E&O insurance is appropriate in our view as administrative errors can occur. Standardizing this requirement in all jurisdictions would assist consumers and reduce business risks for MGAs.

    The application or policy document would clearly identify the broker and the insurer for the consumer, if the consumer wished to take further action.

18. Who would be accountable for errors in consumer transactions processed through MGAs? Are representatives and/or insurers assuming responsibility for the mistakes of an MGA when a consumer is adversely affected?
    Brokers and many MGAs have errors and omissions insurance to protect and compensate the client in the event of a mistake. Ultimately, the insurance company is responsible to its policyholders and would endeavour to reach a suitable resolution.

    We would encourage regulators to adopt a standard requirement for all MGAs to maintain E&O coverage as an appropriate consumer protection tool.

19. Is there an obligation in the agreement between the MGA and the representative for the representative to report to the MGA any complaints received and their status?
    We asked brokers if their contracts with MGAs are requiring more oversight. Proof of regulatory compliance was cited as the most common. A small number indicated that they are required to report client complaints directly to the MGA. This is consistent with their experience that the services provided by most MGAs are related to administrative functions and processing – not one that includes direct involvement with the client.

20. Is there a need for all complaints against representatives or MGAs to have access to the OLHI process and, if so, how might this be accomplished?
    It is our understanding that the OLHI provides a resource for consumers. Life insurance companies also have designated complaints officers and the company has a contractual relationship with the MGA and broker which could be terminated. Ultimately, the provincial/territorial insurance regulator can take action on complaints against a broker or licensed agency by undertaking an investigation and license termination, if required.

Privacy

21. If a consumer is unaware of the existence of an MGA between him/her and the insurer, how is consent being given to MGAs to collect personal information? Are insurers or representatives obtaining consent to disclose to MGAs a consumer's personal data?
    The MGAs in our survey reported having very little direct contact with consumers so it is unlikely they are actively collecting personal information. However, as part of their back office support for brokers, applications are flowed through the MGA en route to the insurer. In this case, the information would generally be covered by the consent given to the broker and the third party permission on the insurance application.

22. Do MGAs retain personal information and, if so, for what purpose? On whose behalf is this information retained?
    Access to a client's personal information may arise in the event the MGA retains copies of an application or stores information on behalf of the broker. Some MGAs have a process in place to return application information to the broker once it becomes a policy.

    Some MGAs have specifically included the ability to audit their brokers' files on a periodic basis in their contract renewals. We have received complaints from brokers that requiring them to make their files available to MGAs is unacceptable as it invades their clients' privacy. Further clarification on this would be helpful.

23. Other than through privacy laws, how are MGAs being held accountable for the privacy of this information today?
    Privacy laws set a reasonable and consistent standard to protect the use of personal information. Other stakeholders may have further comment on this.

MGA Compliance

24. Do you think that the existing licensing regime and the level of required E&O insurance is adequate for the functions of an MGA in today's marketplace?
    Since the licensing requirement and requirement for corporate E&O are not consistent across jurisdictions, we would support a comprehensive approach. This will help ensure consumers are equally protected regardless of where the insurance transaction physically takes place.

25. Is the lack of specific rules on the duties and responsibilities of an MGA generating inconsistencies in how MGAs operate and the level of service they provide?
    We do not see this as a cause for concern, but rather a reflection of the flexibility that exists in the marketplace. As has been pointed out, MGAs vary greatly in size and the services they offer. This is reflected in their contractual arrangements with the insurer and the brokers they deal with. Some insurers may be more flexible in their requirements than others, just as brokers may wish to access more or fewer services from the MGA than it has to offer or use the services of several MGAs.

26. Other than terminating an ongoing agreement, how do insurers deal with MGA misconduct today? Do insurers report MGA misconduct to regulators?
    We would expect insurers to report improper behaviour or the regulatory breaches of an MGA or a broker to regulators as part of their ongoing commitment to ensuring those who represent them are suitable and consistent with CLHIA Guideline G8.