



Issues Paper

**Managing General Agencies**

**Life Insurance Distribution Model**

Agencies Regulation Committee

February 2011

This document reflects the work of regulators who are members of CCIR. The views expressed should not be considered as legal opinions.

This document does not necessarily represent the official position or views of any provincial, territorial or federal government or agency.

**Table of Contents**

- 1. Executive Summary..... 2
- 2. Introduction ..... 3
  - 2.1 Agencies Regulation Committee ..... 3
  - 2.2 Stakeholder involvement to date..... 3
  - 2.3 Purpose of this paper and next steps..... 4
- 3. Definitions and History of growth and changes in regulation ..... 6
  - 3.1 Definitions – Agent, Broker, Advisor, Representative..... 6
  - 3.2 Definition and role of MGA ..... 6
  - 3.3 Definition of AGA – inclusion with MGA ..... 7
  - 3.4 History of the Career Agency Distribution Model ..... 7
  - 3.5 History of the Growth of the MGA/AGA Model ..... 8
  - 3.6 Today’s Representative ..... 9
  - 3.7 Extent of the MGA Model Today..... 9
- 4. Current Regulatory Landscape ..... 11
- 5. Concerns Regarding the MGA Distribution Model ..... 13
  - 5.1. Functions Outsourced to MGAs ..... 13
  - 5.2. Supervision of Representatives ..... 15
  - 5.3 Managing Conflict of Interest Principles ..... 17
  - 5.4. Role of MGAs in Sales Transactions and Handling of Consumer Complaints ..... 19
  - 5.5. Compliance with Privacy Legislation ..... 20
  - 5.6. Who is watching over MGAs? ..... 20
- 6. Conclusion..... 22
  - Consultation Details ..... 23

## 1. Executive Summary

This issues paper documents the preliminary understanding that the Agencies Regulation Committee (ARC) of the Canadian Council of Insurance Regulators (CCIR) has reached regarding the growth of the Managing General Agency (MGA) distribution model in the Canadian life insurance industry.

The move in the life insurance industry from a Career Agency distribution model to a Managing General Agency distribution model may have created a number of risks to consumers and gaps in regulatory regimes. This paper intends to map out the context and situation as ARC understands it, and to stimulate debate regarding the potential issues identified.

Although presented in an MGA context, several of the possible risks identified in this paper speak to a larger issue. One of the key points captured in this issues paper is that there is an apparent lack of clarity as it relates to the roles, responsibilities, accountabilities and appropriate oversight of the agent, the MGA, and the insurer.

For the purposes of this paper, an MGA is defined as an individual, partnership or corporation that holds at least one direct brokerage contract with a life insurance company registered to do business in Canada. Life agents and other intermediaries are, for comprehensiveness, referred to as “representatives.” Today’s representative may deal with any number of insurers either directly or through any number of MGAs. As well, it has been noted that representatives will often move from one MGA to another for a variety of business reasons.

ARC would like to obtain more information and/or seek your input in relation to the themes identified below:

- Functions Outsourced to MGAs,
- Supervision of Representatives,
- Managing Conflict of Interest: Industry Practices Review Committee (IPRC) Principles,
- Role of MGAs in Sales Transactions and Handling of Consumer Complaints,
- Compliance with Privacy Legislation, and
- Who is watching MGAs?

Once these issues are clarified, ARC will be in a better position to determine if the changes to the life insurance industry resulting from the growth of the MGA distribution model are significant enough that the regulatory framework must change so that the regulatory goals of fair treatment of consumers and compliance with laws can be met.

## **2. Introduction**

### **2.1 Agencies Regulation Committee**

This is the first issues paper from ARC. Although the mandate of ARC encompasses many intermediaries working in both Life and Property & Casualty Insurance - MGAs, Wholesale Brokers and Third Party Administrators among them – this first paper deals specifically with MGA and Associated General Agency (AGA) distribution models in life insurance, and, in particular, individual life insurance.

Over the past two decades, the distribution of life insurance has changed dramatically including a significant shift away from the traditional career agency model to MGA and AGA distribution models. Many of the current provincial insurance legislative provisions predate this change.

Canadian insurance regulators, being concerned that current licensing and regulatory regimes were developed while the career agency distribution model predominated and thus may not be adequate given the presence of these new entities in the distribution channel, set up ARC to identify and address risks to consumers and legislative and regulatory issues that may be arising from the activities of MGAs.

Recognizing that licensing issues may be involved, CCIR requested, and received, participation from members of the Canadian Insurance Services Regulatory Organization (CISRO).

### **2.2 Stakeholder involvement to date**

ARC wishes to acknowledge the assistance that has been received to date from a number of industry organizations several of whom have provided us with reports, parts of which have been used in this paper. Special thanks go to:

- The Canadian Life and Health Insurance Association (CLHIA),
- The Canadian Association of Independent Brokerage Agencies (CAILBA),
- Advocis, and,
- The Independent Financial Brokers of Canada (IFB).

The information on the roles and responsibilities of the various market participants contained in the reports from these organizations is not always consistent. Therefore, we decided to append the reports to this paper in order to present them as they were made and avoid any reinterpretation. ARC notes that although each of these organizations is the largest in its field, they do not represent all MGAs, all representatives or all life insurers.

ARC also wishes to acknowledge the facts and findings gathered by the Intermediary Regulation Working Group (IRWG), which was established by CCIR in the fall of 2009 to examine the effectiveness of insurers' compliance monitoring systems with respect to the selling of Individual Variable Insurance Contracts (IVICs) by insurance intermediaries. These market conduct reviews included on-site visits to insurers to gain further insight into insurers' practices for supervising intermediaries. In total, there were 10 life insurance companies reviewed representing a range of large, medium and small size companies that make up 92% of the market share for IVIC products. The work also included a review of the relationship that insurers have with MGAs and a review of some of the contracts between insurers and MGAs. ARC has used some of those findings to gain a better understanding of the MGA distribution model. However, because the focus of the IRWG's review was on the distribution of IVIC products and not exclusively related to MGAs, many outstanding questions remain and will be explored further in Section 5 of this paper.

### **2.3 Purpose of this paper and next steps**

This is an issues paper – it is intended to map out the context and situation as we believe it currently exists and to point out places where the proliferation of the MGA/AGA model may be affecting consumers either directly or by challenging the effectiveness of current regulatory legislation and practices. **Its purpose is to stimulate debate about the issues noted in this paper and launch a process of consultation on those issues as well as to educate and to build a common understanding of the topic and issues for both regulators and stakeholders.**

We seek several kinds of input from stakeholders:

- Whether the description of the topic is factually correct,
- Whether the issues identified are, indeed, significant (i.e. have the potential to negatively affect consumers),
- Whether all significant issues have been identified, and
- Clarification on the roles and responsibilities of each industry participant (MGA, AGA, Representative, Insurer), and whether these roles have been affected by the advent of the MGA distribution model.

The remainder of this paper is divided into four sections:

- *Section 3* sets out the definitions of MGA, AGA, agent, broker etc. as we understand them. It also sets out the history of the career agency system and the evolution to the MGA model. ARC would welcome any feedback on the facts presented, and has set out some specific questions it would appreciate responses to,

- *Section 4* briefly describes the current regulatory landscape that applies to insurers, representatives and MGAs,
- *Section 5* sets out the concerns identified by ARC. Again, ARC would welcome any feedback on those concerns and responses to the specific questions set out in that section, and
- *Section 6* sets out the conclusion and methods for replying to this paper.

After this consultation process, a final version of the Issues Paper will be presented to CCIR for consideration. If CCIR agrees at that point that there are significant issues that need regulatory attention, ARC would then proceed to develop a Position Paper which would be published for consultation.

### 3. Definitions and History of growth and changes in regulation

#### 3.1 Definitions – Agent, Broker, Advisor, Representative

Although the definitions of “agent” and “broker” differ somewhat from province to province, generally speaking, a life insurance **agent** is a licensed individual who has a contract to place insurance with at least one insurer. In common law jurisdictions, life insurance representatives are considered “agents” of the insurer, whereby the insurer is obligated to uphold the agreements made by the agent with a third party (see Section 4 for more details).

In life insurance, a **broker** is an agent with contracts with a number of insurers. Generally they consider themselves independent of the insurers, but, for life<sup>1</sup> insurance, the agency relationship still holds in common law<sup>2</sup>.

“**Advisor**” is a more generic term in financial services for one who provides financial advice. Many insurance agents will call themselves advisors. Many of these will be dually licensed, holding licenses to sell mutual funds or other investment products in addition to their life insurance licenses.

Because these terms are often used interchangeably in general speech, in this report we will use the term **Representative**, which we take from the *Quebec Act Regarding the Distribution of Financial Products and Services* where “Representative in insurance of persons” (life insurance) is defined as “a natural person who offers individual insurance products in insurance of persons or individual annuities from one or more insurers directly to the public, to a firm, to an independent representative or to an independent partnership.”

#### 3.2 Definition and role of MGA

For the purposes of this paper, an **MGA** is defined as an individual, partnership or corporation that holds at least one direct brokerage contract with a life insurance company registered to do business in Canada.

Within the industry, the entities referred to as MGAs vary greatly in their structure, the services they provide and the contractual obligations they have to both insurers and representatives. In performing these services the MGA is not normally dealing directly with the public, though

---

<sup>1</sup> Note that in common law, the agency relationship does not generally hold for general (property and casualty) insurance brokers unless there is a specific agency binding agreement in place.

<sup>2</sup> Note that in Quebec, the *Civil Code of Quebec* enacts rules similar to those provided in the common law (e.g. mandate or apparent mandate), which could find application under certain circumstances.

the information about a client that the representative has gathered will be seen by the MGA. It should also be borne in mind that many MGAs have related parties that are registered mutual fund or securities dealers through which a dually licensed representative may place that kind of business.

An MGA is a conduit that facilitates business between the representatives, their clients, and insurers by providing some or all of the following services:

- Supporting and assisting a representative in obtaining contracts with insurers, which can include granting authority to a representative to act on behalf of an insurer,
- Processing and tracking representatives' business submitted by a representative,
- Providing representatives with direct sales support,
- Facilitating the two way flow of information between the insurer and the representative,
- Pooling of commission payments for the representative from various insurers,
- Facilitating the submission of completed contracting requirements between a representative and an insurer,
- Training representatives,
- Providing market conduct compliance support to insurers, and, in some cases,
- Developing products and/or assisting in the adjusting of claims on behalf of an insurer.

### 3.3 Definition of AGA – inclusion with MGA

In addition to MGAs there exist in the industry entities called AGA - Associated General Agency. These AGAs appear to be either an arrangement where groups of representatives contract together with an MGA, or have banded together to form a small MGA. In either case, their roles and responsibilities appear to be some subset of those of an MGA. We therefore have included them in the definition of MGA throughout this paper.

#### Questions to Stakeholders:

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?

### 3.4 History of the Career Agency Distribution Model

Since the beginnings of the life insurance industry well over 100 years ago, common law has held that life insurance representatives are true agents of the insurer, that is, the insurer is bound by the actions of the representative, even those where the representative has acted



without actual authority<sup>3</sup>. Therefore, life insurance companies have had good reason to closely monitor the actions of their representatives. Until recently, this was done by the insurer recruiting and training representatives directly who would then work for them exclusively, often for their whole careers. This is the basis for the traditional life insurance “career agency” distribution model.

In this career agency distribution model the life insurer had a branch network, often with offices in many communities. The representatives reported into the branches, sometimes even having an office there. The staff and manager of the branch were all employees of the insurer. The branch looked after the backroom processing of the business the representatives brought in and were responsible for ongoing training and supervision of the representatives as well as reporting representatives for discipline if they acted outside company policies.

Also, a requirement existed in most provincial insurance licensing regimes, and still does in a number of jurisdictions, that a person had to be sponsored by an insurer before he/she could be licensed as a representative. The requirement shows that the traditional one-on-one relationship between representative and insurer was assumed in the regulatory regimes. Regulators would contact the sponsoring company to take action if they had an indication (through consumer complaints or other means) that a representative might be acting inappropriately. Indeed, the regulatory powers of most insurance regulators have been focused more on dealing with and through insurers rather than with representatives directly.

### **3.5 History of the Growth of the MGA/AGA Model**

CAILBA, in their submission to ARC, noted that the origins of life Insurance brokerage activity in Canada go back to the early 1970’s with both Maritime Life and Aetna Life using this model. It wasn’t until the late 1990’s that many of the major life insurers (Canada Life, Sun Life, Standard Life, Manulife, and Prudential, among others) began to dismantle their career branch systems in favour of contractual arrangements with life brokerage firms, which became known as MGAs. Often it was the former career Branch Managers, disenfranchised by their respective companies, who created MGAs to provide a “home” for the now independent representatives.

---

<sup>3</sup> See previous footnote for the application of this principle in Quebec.

The advantages to life insurers of the MGA product distribution model include:

- It is far less capital intensive,
- It eliminates a number of fixed costs (premises, staff etc) and replaces those costs with a variable cost structure more closely tied to production, and
- It provides the opportunity to expand product distribution through a broader range of life insurance sales organizations.

Several of the larger life insurers like London Life, Great West Life, and Sun Life still maintain career agency branch systems for at least part of their business, but this system is clearly waning.

### **3.6 Today's Representative**

Unlike the Career Agency model, where there was a one-on-one relationship between an insurer and a representative, in today's marketplace, most representatives are now independent and often deal with more than one MGA in order to obtain the coverage that is most appropriate for the consumer, or, at times, in order to maximize their compensation. Insurers often contractually require a representative to place all business with that insurer through the same MGA (for example, Insurer A requires that all business from Representative Q be placed through MGA X while Insurer B requires that same representative to use MGA Y for Insurer B's business).

So, today's representative will often deal with any number of insurers either directly or through any number of MGAs. Also, they often move from one MGA to another for a variety of business reasons.

### **3.7 Extent of the MGA Model Today**

One of the difficulties that ARC has faced is a lack of data on MGAs: how many there are, what functions they perform, what their contractual responsibilities are, etc.

It is not possible to identify all the entities acting as MGAs through licensing records as there is no specific licensing category for MGAs. Therefore, we know neither the exact number of entities with MGA contracts nor the size or scope of their operations.

The CLHIA reports that over the past 10-12 years MGA Life Insurance product distribution has become a dominant distribution channel.

In terms of volume, the MGA channel has recently emerged as the largest source of new individual life business for the life industry. According to Investor Economics, between 2003 and

2007, the dollar value of new premiums from this channel increased by 50% so it now accounts for just over one-third of all new premiums for this segment.

Estimates of the number of MGAs vary, in part because the concept is not consistently defined. Investor Economics estimates there are upwards of 400 agencies in Canada, of which approximately 100 are what it calls “bona fide” MGAs.

In a 2009 presentation on the future of MGAs, Mr. James Virtue (CA, CLU, CFP, President, Financial Management Group of Companies Inc.) noted that there are three basic classifications of MGAs in existence in Canada at present with the following general characteristics:

- Large national MGAs
  - Multiple offices (across geographic regions),
  - Contracts with most companies,
  - Administrative system,
  - Staff structure, and
  - Aware of compliance issues – at various levels, working on issues.
- Regional MGAs
  - One or a few offices in a geographic region (example West or Ontario),
  - Focuses production on one or two companies,
  - Have multiple contracts (some MGAs),
  - Administrative system,
  - Staff structure (not as developed), and
  - Aware of compliance issues.
- Small Local MGAs
  - One office,
  - Focuses production on one or two companies,
  - Might have administrative system,
  - Family or small staff,
  - Owner is often a producer, and
  - Largely unaware of compliance issues.

It is not yet clear to ARC how many MGAs fit into each of these categories.

## 4. Current Regulatory Landscape

The responsibilities of insurance representatives and insurance companies are established by virtue of law governing insurance: contract law; agency law; tort law; statute law; and, in Quebec, civil law<sup>4</sup>. Insurance contract law sets out the insurer's legal obligations to the policyholder in exchange for payment (premium). Therefore, regardless of the fact that the policy was sold by an independent insurance representative or the fact that an insurer delegates certain functions to another party such as an MGA, an insurer is ultimately responsible for its product by virtue of the insurance contract between the insurer and the policyholder.

Agency law governs the agency relationship between an insurer and an insurance representative, regardless of the fact that the insurance representative may act on behalf of more than one insurer, through one or various MGAs. Agency is a relationship in which one person is authorized to represent and act for another person. In the field of insurance, the "principal" is the insurance company and the "agent" is the representative. There are a number of court decisions under agency law that clearly set out the circumstances when an insurer is responsible to the policyholder. Similarly, there have also been court decisions under common law that clearly set out the circumstances when a representative is responsible to the policyholder (e.g. advice giving, recommendation of a product).

Tort law deals with legal liability issues usually involving damages for negligence. Under tort law, there are a number of court decisions which clearly set out the circumstances when an insurance company has been found negligent in fulfilling its contractual obligations to the policyholder (e.g. unfair denial of a claim). Similarly, there are a number of court decisions which clearly set out the circumstances when a representative may be found negligent in its responsibilities to his/her client (e.g. providing unsuitable advice, putting their interest ahead of the client's interest).

Finally, there is statute law which varies in jurisdictions across Canada and focuses on regulating the market conduct of insurance representatives and insurers. Under statute law, insurance representatives must meet certain criteria before they are issued a licence to sell insurance. The criteria include:

- The successful completion of an education program demonstrating that the individual has the required set of skills and knowledge to enter into the profession,

---

<sup>4</sup> It should be noted that the *Civil Code of Quebec* enacts rules similar to those provided in the common law about contract law, agency law and tort law, which could find application under certain circumstances.

- The person's background demonstrates that the person is otherwise suitable to receive an insurance license, and
- Evidence of Errors and Omissions Insurance (E&O) that is intended to protect consumers from errors by the insurance representative.

In addition to meeting such criteria, insurance representatives are required to comply with the laws of the jurisdiction in which they are conducting business, as well as any established industry standards or codes of conduct. Under these provincial statutes, regulators usually have a role to remove from the marketplace those representatives engaged in conduct that is not suitable (e.g. misrepresentation of an insurance product, fraud, forgery etc). However, generally, the regulator does not have the authority to obtain restitution on behalf of a consumer. Therefore, the legislative requirement for insurance representatives to maintain their E&O insurance coverage is an important consumer protection measure. However, as with any regulatory system, even though there are a number of safeguards in place designed to protect consumers, there will always be cases from time to time involving criminal acts by a licensed insurance representative. No regulatory system can ever replace the criminal justice system for criminal acts.

Currently there is no jurisdiction with specific legislation governing the functions that an MGA performs on behalf of an insurer or a representative. Most provincial licensing legislation was implemented before MGAs become a central part of the life distribution model. However, due to the prohibition that exists in most jurisdictions regarding the payment of commissions by insurers, most MGAs or their principals are licensed as insurance representatives even though they do not directly engage in any retail insurance activity.

## 5. Concerns Regarding the MGA Distribution Model

ARC would like to obtain more information and/or seek your input in relation to the themes identified below:

### 5.1. Functions Outsourced to MGAs

Based on the submissions from CAILBA and CLHIA, and the sample of MGA contracts provided to FSCO during the on-site reviews conducted on behalf of the CCIR Intermediary Regulation project, there seems to be considerable variability within the industry in terms of what functions individual companies delegate to MGAs in practice.

In addition to recruiting representatives, and back-office administrative tasks, most companies operating within the MGA channel appear to delegate a variety of specific functions related to compliance such as screening representatives for suitability and monitoring their behaviour. Training of representatives also seems to be a frequently delegated function, but assistance with the handling of complaints and oversight of a representative's sales practices may or may not be delegated to an MGA.

Not only are there differences among insurers in what functions they choose to delegate to MGAs, but a company may also choose to delegate different functions to different MGAs.

For example, compliance functions seem to be delegated more often within the context of National Account agreements (i.e. an MGA who is also an investment dealer) and recruiting and administrative functions more often within the context of agreements with small-size MGAs, but ARC is not certain if this is the norm.

#### Questions to Stakeholders

3. What are the factors considered by an insurer before deciding whether or not to outsource an activity to an MGA?
4. How do insurers satisfy themselves that MGAs have the expertise to carry on the delegated functions (e.g. product training, product development, etc.)?
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?
6. Do insurers view functions outsourced to an MGA/AGA as material to their risk management process?
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?
8. What can be done to enhance compliance monitoring of functions outsourced to MGAs? Would standardize compliance monitoring guidelines assist smaller insurers?

Although the majority of insurers have policies and procedures in place to ensure functions delegated to MGAs are being carried out in an appropriate manner, the information obtained from the site-visits that were conducted as part of the Intermediary Regulation project showed that there is room for improvement with respect to compliance monitoring (i.e. ensuring that insurer's and MGA policies are actually followed and documented by the MGA). Most deficiencies were found in smaller insurers with less robust monitoring and no clear plans to address the gaps relating to the MGA distribution channel in the near future. The Intermediary Regulation report recommended that ARC addresses this issue.

Therefore to ARC, it seems as if there is currently no standardized approach regarding:

- What functions and responsibilities are delegated to MGAs, and
- The quality of compliance monitoring by insurance companies of functions delegated to MGAs<sup>5</sup>.

ARC is concerned that the absence of a clear and consistent approach to how the channel operates may have the potential to create issues in the marketplace and put consumers at risk.

ARC recognizes that insurers have a legitimate interest in outsourcing some aspects of their operations and compliance functions. It also understands that the insurer remains accountable for ensuring that the delegated functions are handled properly (i.e. a company does not abdicate responsibility for a service by handing it over to someone else).<sup>6</sup>

However, an insurer cannot be certain that delegated functions are handled properly by MGAs unless it has "appropriate safeguards" in place for any outsourcing or delegation of activities, keeping in mind that different safeguards will be appropriate for different

---

<sup>5</sup> Note that ARC was told that in June 2010, companies represented on the CLHIA Committee on Distribution and Intermediaries agreed in principle to support a more standardized approach for assessing the compliance monitoring delegated to MGAs.

<sup>6</sup> Although the federal guideline on outsourcing, OSFI guideline B-10, does impose responsibilities on insurers to oversee outsourcing arrangements, the materiality criteria temper the application of these oversight responsibilities to MGA contracts.

In Quebec, the Autorité des marchés financiers, in its April 2009 guideline on outsourcing ("Outsourcing Risk Guideline"), specifically established the responsibility of insurers with regard to material outsourcing arrangements. Under this guideline, any outsourcing arrangement that may have a major impact on an institution's financial condition, its operations and, ultimately, its reputation is therefore considered to be material. If an insurer enters into any such agreement with an MGA, the guideline will apply.

functions, and will depend on the scale, nature and complexity of the function. Insurers may expose themselves to increased risks if too much is delegated or if there aren't sufficient controls in place to monitor what has been delegated to an MGA.

## **5.2. Supervision of Representatives**

One of the roles of the insurance regulator has been to ensure the compliance of representatives with laws and regulations and, when infractions are discovered, to either censure or remove the representative from the insurance marketplace.

In Ontario insurers have a legal responsibility to supervise and report to the regulator any misconduct by the representatives that act on their behalf. As well, most insurers incorporate CLHIA Guideline 8, which describes practices insurers must follow to screen and monitor the suitability of their representatives, into their internal policies.

It is important to clarify what we mean by "supervision" when we refer to the Insurers' supervisory role. Traditionally this role has centered on the establishment of a monitoring and reporting system to screen representatives selling the insurers' products to ensure that they are licensed, carry E &O, have fulfilled any continuing education requirements, and are not engaging in inappropriate behaviour (e.g. not misrepresenting the product they are selling, not exercising undue influence, etc.). Determining that the product sold is suitable for the client's needs is excluded from this definition and is discussed separately in section 5.3.

No amount of supervision can prevent incidents of inappropriate advice by a representative. However, it is possible, in the course of monitoring the activities of a representative, for an insurer to come across information that clearly demonstrates that the representative may not have the appropriate skills and knowledge to sell insurance products. For example, a representative selling a disability policy to a person who does not meet the policy eligibility criteria (e.g. over 65 years of age); or where there have been multiple complaints about one representative, all dealing with the same issue. In cases where there is evidence supporting the unsuitability of a representative to deal with clients, it is expected that insurers would report that information to the appropriate regulator in accordance with the laws and/or standards set out in the CLHIA Guideline.



With today's MGA structure in place, ARC would like to learn if monitoring "representative suitability" has become more difficult for the insurer as a representative may be associated with multiple insurers and MGAs at a given time. There is a potential for a representative to spread questionable business among his/her various MGAs and insurers to avoid notice. It is also unclear who would be primarily responsible to report misconduct in the absence of a one-to-one relationship.

From the MGA contracts reviewed, it seems that insurers usually delegate to MGAs the screening function over representatives. However, according to the findings of the Intermediary Regulation project, some insurers (generally smaller companies) do not have robust systems in place to ensure that MGAs are adequately performing this function (i.e. representative suitability), including reporting any representative misconduct in a timely manner.

Also of concern to ARC is that a review of MGA agreements showed that varying levels of delegation of the screening function (i.e. the expectations of the insurer) exist from one agreement to the next, especially with respect to misconduct.

For example, some MGA contracts impose an obligation on the MGA to inform the insurer about any representative misconduct. Other MGA contracts only impose an obligation on the MGA to communicate to the insurer if it terminates a representative and why. Some insurers maintain a right to terminate a representative at their sole discretion. Some insurers seem to work with the MGA to investigate misconduct, but this doesn't seem to be always the case since in some distribution channels (e.g. National Accounts), the insurer may not have a direct contract with representatives, so the sole responsibility for screening and monitoring would rest on the MGA.

#### Questions to Stakeholders

9. What specific activities do insurers carry on today in supervising representatives and reporting misconduct?
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.
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?
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?
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?

ARC is concerned that the expectations of each party - insurer, MGA and representative - are not clearly delineated within the context of the MGA distribution model. If the insurer does not have a direct contract with the representative, is the obligation to report misconduct to the regulator being transferred to the MGA? ARC wonders whether or not there is clarity in today's marketplace, given the multiplicity of players and contractual arrangements, about who is responsible to investigate and report misconduct to the regulators. As well, in the case of dually licensed representatives who do business with both an MGA and a related securities or mutual fund dealer, ARC would like to know whether misconduct in one financial sector should be communicated to regulators in the other sector.

### 5.3 Managing Conflict of Interest Principles

In June 2006, after release of a consultation paper and consideration of the responses received, the CCIR formally endorsed the three *Principles to Manage Conflicts of Interest*:

1. **Priority of the client's interest:** An intermediary must place the interests of policyholders and prospective purchasers of insurance ahead of his or her own interests.
2. **Disclosure of conflict or potential conflict of interest:** Consumers must receive disclosure of any actual or potential conflict of interest that is associated with a transaction or recommendation.
3. **Product suitability:** The recommended product must be suitable for the needs of the Consumer.

In 2008, CCIR followed up current practices and application of the *Principles to Manage Conflicts of Interest* in the marketplace with insurers across Canada. Overall, the surveys indicated that support of the three above noted principles was high, that the three principles are widely recognized by the marketplace, and that most companies have systems of corporate governance and internal controls to manage conflicts of interest as they relate to the principles.

Most (albeit not all) of the MGA contracts reviewed by ARC included the insurer's Code of Conduct, which generally incorporated the three conflict of interest principles.

ARC understands that MGAs have very little direct involvement with consumers. Indeed, it is unlikely that many consumers are even aware that another entity has been involved in their insurance transaction. Because MGAs are not normally dealing directly with the public, the feedback received by ARC to date from the industry seems to suggest that:

- There are no disclosure requirements from the MGA to consumers, and
- Product suitability remains the responsibility of the representative dealing with the customer, and of the insurer, in terms of overseeing that the information provided to clients on a particular product is accurate and complete (i.e. no misrepresentation).

Notwithstanding the above, there are two areas that ARC needs to explore further:

- MGAs receive a trailer commission from the insurer based on volume of business generated through the representatives. Sometimes a portion of the override received by the MGA is directed to be paid to the representatives. Some of the MGA contracts reviewed by ARC require a minimum volume of production, and
- Some MGA contracts delegate supervision of representatives' sales practices. The terms of this delegated function are usually vague. Whereas it is understood that the obligation is on the representative to ensure that the product recommended is suitable to the client, it is unclear to what extent MGAs are expected by insurers to ensure that representatives are complying with, and documenting, any needs analysis.

#### Questions to Stakeholders

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?
15. Given that MGAs receive 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?
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)?

#### 5.4. Role of MGAs in Sales Transactions and Handling of Consumer Complaints

According to industry feedback received to date, it appears that neither MGAs nor insurers or representatives view MGAs as having a responsibility to the consumer. This seems to be because there is no direct relationship between the consumer and the MGA. Notwithstanding this lack of relationship, ARC noted in its review of MGA contracts that complaints handling is sometimes delegated to the MGA, or there is an obligation on the MGA to assist insurers in their investigation of complaints.

It is unclear to ARC, from its review to date, what is actually being delegated with respect to complaint handling. For instance, it is not known under what circumstances an MGA is delegated complaint handling, or how often it is delegated, or the terms of the delegation. Additionally, ARC would like to establish whether the delegation is related to the product sold by the representative (and for which the insurers' obligations are established either by contract between the insurer and the policyholder or by agency law) or otherwise. ARC still needs to determine if insurers expect MGAs to handle complaints regarding the actions of a representative and, if so, what are the role and the responsibilities of the MGA in this regard. ARC is also interested in knowing how complaints related to errors in the insurance transaction – which may have been introduced either by the representative or by the MGA itself – are handled.

ARC would also like clarity about the role the MGA plays in the consumer's right to pursue a complaint through a third party dispute resolution mechanism, that is, through the OmbudService for Life and Health Insurance (OLHI). As ARC understands it, representatives and MGAs are not members of OLHI. Hence, OLHI cannot deal with complaints against them unless an insurance company advises OLHI it is willing to take responsibility for their actions. This lack of access to an independent third party dispute mechanism where an insurer declines to accept responsibility for a complaint may be a risk to consumers.

##### Questions to Stakeholders

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?
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?
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?
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 reasonable to assume that the introduction of the MGA in the distribution chain between the insurer and representative, performing functions such as reviewing applications for completeness, delivering applications and monies received by representatives to the insurer, keeping records and holding monies in trust, has the possibility of resulting in errors in the insurance transaction attributable to the MGA.

Where there are errors in the insurance transaction attributable to the MGA or to the representative, ARC wants to make sure that there is certainty about who should take responsibility, and that consumers know who to go to with a complaint.

### **5.5. Compliance with Privacy Legislation**

The personal information of an insurance applicant gathered by the representative flows through the MGA on its way to the insurer. Insurers may also be disclosing the personal data of their customers to MGAs to process on their behalf. It is unclear to ARC whether MGAs are directly retaining client records containing personal information, or doing so on behalf of the insurer or the representative. Either way, the express consent of the customer may be required (i.e. for the MGA to retain or for the insurer/representative to disclose to the MGA).

Industry reports received by ARC to date indicate that MGAs are governed by federal or provincial privacy statutes and thus bound to protect the privacy of personal information. Also, the MGA agreements reviewed by ARC would generally include provisions which imposed an obligation on the MGA to comply with privacy laws and to train its representatives regarding their obligations with regard to these legal requirements.

Notwithstanding the above, ARC needs confirmation that the handling of personal information by an MGA is indeed happening with the consumer's knowledge and consent.

### **5.6. Who is watching over MGAs?**

#### **Questions to Stakeholders**

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?
22. Do MGAs retain personal information and, if so, for what purpose? On whose behalf is this information retained?
23. Other than through privacy laws, how are MGAs being held accountable for the privacy of this information today?

ARC would like to have a better understanding regarding who is overseeing the conduct of MGAs and to whom these entities are accountable. Are MGAs adequately supervised in light of the functions they perform?

MGAs may not be adequately supervised by insurers as the Intermediary Regulation report concluded that there are gaps regarding insurers monitoring the functions delegated to their MGAs.

It seems that most MGAs are currently licensed as life insurance agents because their principals write business themselves or because the MGA entity receives commission payments from insurers. As such, they are bound to life agent requirements such as E&O insurance. However, provincial licensing legislation was implemented before MGAs became a central part of the life distribution model so there is no specific licensing category for MGAs in any Canadian jurisdiction addressing the specific role that this new middleman performs in the marketplace.

According to the CLHIA, the functions of a typical MGA fall under three general categories: back office support between representative and insurer for sales transactions; sales and marketing support for the representative; and market conduct compliance support for the insurer. As there are no accepted minimum standards to perform these functions (in regulation or under MGA contracts), ARC is concerned that there may be inconsistencies in how MGAs operate and that there may be no clear lines of accountability.

#### Questions to Stakeholders

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?
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?
26. Other than terminating an ongoing agreement, how do insurers deal with MGA misconduct today? Do insurers report MGA misconduct to regulators?

## 6. Conclusion

As the life insurance industry changes over time, the regulatory framework may need to change as well so that the regulatory goals of fair treatment of consumers and compliance with laws can be met.

The changes in the distribution of life insurance over the past two decades including the increased independence of representatives and the proliferation of the MGA model may have created gaps in legislative compliance that could put consumers at risk. Your input will help ARC determine whether or not there are regulatory gaps that need policy attention.

ARC welcomes the comments, suggestions and ideas of the industry and consumers associations on the issues described in this issues report. Both to assist stakeholders and to solicit feedback on specific issues of interest to ARC, questions for stakeholder consideration have been included throughout this paper. These are not intended to exclude comment on any other issues that stakeholders may wish to cover.

In addition to the specific questions, ARC seeks several kinds of input from stakeholders:

- Whether the definition and role of MGAs described in this paper is factually correct,
- Whether the concerns identified are, indeed, significant,
- Whether all significant issues have been identified, and
- Clarification on the roles, responsibilities, and accountabilities of the agent, the MGA and the insurer.

**Consultation Details**

An electronic copy of this document is available on CCIR's website at [www.ccir-ccrra.org/](http://www.ccir-ccrra.org/).

We look forward to receiving your submissions by April 8th, 2011.

**Electronic submissions are preferred** and should be forwarded to [ccir-ccrra@fSCO.gov.on.ca](mailto:ccir-ccrra@fSCO.gov.on.ca).

Written submissions should be forwarded to:

CCIR Secretariat  
5160 Yonge Street, Box 85  
17th Floor  
Toronto, Ontario M2N 6L9

CCIR intends to make the submissions received publicly available. If you indicate that you do not want your submission or specific parts of your submission to be made public, we will treat the submission, or the designated parts, as confidential to the limited extent permitted by law.



## **Appendix**

CAILBA report

CLHIA report

Advocis letter

IFB letter and report



Report for: **Canadian Council of Insurance Regulators (CCIR)**  
**Agency Regulation Working Group**

Subject: **MGA Definition and Summary of Operations**

Prepared by: **CAILBA – MGA Working Group**

Reviewed by: **Agency Review Committee (ARC)**

Date: **March 2010**

## **The Report**

The Report has been prepared for the Canadian Council of Insurance Regulators (CCIR) Agency Regulation Working Group with the purpose of providing a summary of the roles and responsibilities of MGA's and their Advisors. The Introduction portion of the Report is a brief history of the evolution of the MGA, followed by the main portion of the Report which is broken down into each of the various aspects or functional areas of MGA operations.

## **Introduction**

### **Evolution of MGAs past to present**

The origins of Life Insurance brokerage activity in Canada go back to the early 1970's with both Maritime Life and Aetna Life. The actual emergence of the MGA Life brokerage distribution system began approximately 30 years ago but has gained far more prominence since the latter part of the 1990's. Prior to that evolution, the distribution of Life Insurance and related products had been dominated by the 'career' system, wherein Insurers each had their own captive sales organizations.

In the late 1990's many of the major Insurers (Canada Life, Sun Life, Standard Life, Manulife, Aetna, and Prudential (among others) began to dismantle these expensive career branch systems in favor of contractual arrangements with Life Brokerage firms, which became known as Managing General Agencies or MGA's. The advantages of product distribution utilizing MGA's were (1) far less capital intense, (2) allowed Carriers to eliminate a number of fixed costs (premises, staff etc) and replace those costs with a variable cost structure more closely tied to production and (3) the opportunity to expand product distribution through a broader range of Life sales organizations, leaving today companies like London Life, Great West Life, Sun Life (acquired Clarica) maintaining their career branch systems.

These processes were slow to evolve. In many cases the career Branch Managers, who were managers for the career Insurers, became the entrepreneurs who created MGA's to provide a 'home' for the Advisors who had become disenfranchised by their respective companies.

Over the past 10-12 years MGA Life Insurance product distribution has become a dominant distribution channel. In the early stages of the evolution, MGA's were generally local or regional, with the principal(s) also being licensed and active in the sales process with their own client base. At that time, still in its infancy, MGA's represented just 2 or 3 insurers. The MGA contracts with these insurers were production based and in turn therefore, their contracts with their Advisors were also production based. The vast majority of the Advisors in an MGA organization were actually groomed in a career system.

Submitted business (Life & Segregated Funds) was "paper based". Applications were sent or dropped off at the MGA's office, where a modest amount of record keeping was done, primarily to track commissions; the applications were then sent to the insurers, approved contracts were returned to the MGA for delivery to the Advisor and subsequently commissions were paid. Interestingly, commissions were/are most often paid directly to the Advisor straight from the insurer. Advisors are still required to contract with and be approved by the insurer. The financial contract between the insurer and the Advisor only became binding with the submission and acceptance of the first piece of business. Few MGAs at that time had any Advisor contracts and underwriting requirements were/are the responsibility of the Advisor.

It is also important to note that notwithstanding the emergence of the MGA Brokerage distribution system, the Insurers continued to set the new business submission standards for both Advisors and

MGA's. Ultimate responsibility for product, product application and policy acceptance continues to remain with the Insurer.

As the career agency system for many of the Insurers, which had been the backbone of the Life Insurance industry since its infancy in Canada, evolved into brokerage, this created an opportunity for the emergence of a whole new business model, the MGA. The majority of managers, administrators and Advisors that were terminated by their respective Insurance Companies, as they dismantled their career systems, needed to earn a living and were looking for places to resume chosen careers. Hence the rush of the new business model, the MGA. The MGA at the time was singular in focus, to recruit the displaced Advisor. All resources, time and energy was devoted to that recruiting task.

During this period little changed in what an MGA actually did; they continued to consolidate production to maximum production bonuses and transacted business with 2 or 3 insurers, usually with the insurer and the product line with which they were most familiar, that of the Insurer with whom they had been a career agent or manager.

In the period since 1998 the MGA business began to evolve and expand the model beyond simply production consolidation. There are many reasons for this evolution, not the least of which was opportunity and entrepreneurial spirit. MGAs grew from local/regional to regional/national in scope. From just representing 2 or 3 insurers, their growing levels of production enabled them to represent in many cases 10 or more insurers.

From being owned and operated by a producing principal many MGA's have evolved into multi partner national corporations with very few principals continuing to produce and/or manage a book of business. Competition among MGA's created the need for a better value proposition and caused MGAs to introduce product and services beyond simply business tracking, consolidation and compensation. Enhancements included faster more efficient new business processing systems, product training, business development and practice management, conferences, campaigns, recognition programs, branding and much more.

Advances in technology also have contributed to change. These included the electronic processing of segregated funds via FundSERV and electronic processing of Life business. 'Straight through' Life Insurance electronic processing from the Advisor or MGA to the Insurer takes place today on a limited basis. Insurers that accept electronic feeds require that these feeds include business submission standards and business processing standards.

The MGA business was no longer a Mom & Pop Operation.

This was now BIG BUSINESS, MGAs now represent the overwhelming majority of insurance product production in Canada; CAILBA's membership represents in excess of 75% of Canadian MGA brokerage production.

### **The Report, MGA Operations and the Advisor**

The Report has been prepared by CAILBA. CAILBA formed an MGA Working Group made up of CAILBA MGA members of various sized MGA's from across Canada. CAILBA also received comment from and content suggestions for the Report from CLHIA, Advocis and IFBC.

**The Report includes the Advisors' Responsibilities.** Advisors are responsible for product selection and the suitability to the needs of the client. The Advisor is also responsible for record keeping, client files, meeting notes, adherence to investment suitability guidelines (IPRC), needs analyses, disclosure forms, adherence to insurers' industry professional designation and Code of Conduct Guidelines, privacy & confidentiality, DNC Compliance and AML and so forth. Within the context of MGA operations, these are clearly Advisors' areas of responsibility.

**The Report will also include Insurers Areas of Responsibilities.** The Insurers are responsible for all aspects of their products including application, design, performance as well as all marketing material in either paper or electronic format. This also includes Privacy, AML or FinTrac legislation presentations, concepts, and associated materials and the field representative training of reps on their products/concepts, joint field work and the advice they provide via their estate & tax planning consultants.

**MGA Operations and the Advisor** - In the MGA's role as it relates to the Financial Advisor, there are the following points to consider. The MGA was not and is not involved in the discussions between the Advisor and the Advisor's client and therefore plays no role in the Advisor recommendation of product or Insurer. The MGA did not manufacture the product and/or their related guarantees and makes no suitability determination either expressed or implied. The MGA role with respect to the Financial Advisor does not include the determination of product suitability.

As stated, in the infancy of the evolution of the MGA, MGAs simply consolidated business and earned volume bonuses. If this were still the case today then clearly a MGAs role in managing Financial Advisor activities would be extremely limited. However, as MGAs evolved and in a response to Financial Advisor's needs as well as the attempt to differentiate themselves from their MGA peers, MGAs began to offer and provide all or some of the following services to the Advisor: product consultation, training, concepts, branding, business development, conferences, campaigns, contests, offices, benefits and more.

Therefore, in the evolution of the MGA, they have continued to improve and expand the value proposition to the Advisor with the addition of more and more services.

### **Know Your Financial Advisor – The Role of the MGA**

The foregoing has been a brief history of the MGA and how the business model has evolved. The MGA/Financial Advisor relationship "Knowing Your Financial Advisor" is akin to Knowing Your Client, from the perspective of the MGA. It is imperative that MGA's know who their Financial Advisors are, the type of client/business activities in which they are involved as well as their adherence to industry standards in business practice management. An Advisor can be contracted with and very often are contracted with more than one MGA. This occurs more frequently with smaller MGA's who do not carry the complete product range required by the Advisor.

The Smaller MGA's who only hold an MGA contract with one or two or so Insurers may sign an AGA contract with an MGA who has an MGA contract with Insurers with whom their Advisors would like to do business. This AGA business relationship with the MGA is subject to the approval of each Advisor by the Insurer.

An MGA may be both an MGA with certain Insurers and an AGA of an MGA with other Insurers.

An AGA that holds no MGA contract(s) with an Insurer is simply an AGA.

**MGA - Know Your Financial Advisor**

- Quality of submitted business
- Completeness of submitted new business applications
- Submitted/settled ratio
- Business Persistency or Lapse Rate
- Volume of submitted business
- New and in force business practice management
- Professionalism and general business conduct

## **MGA Report on Operations**

### **MGA Business Model – Definition**

An MGA is an incorporated distribution organization that holds at least one (1) direct MGA brokerage contract with a Canadian Life Insurance company.

- Most MGA's have multiple Insurer contracts.
- The larger national MGA's could have up to 14 Insurer contracts.
- The Insurer MGA contract is granted by the Insurer at the sole discretion of the Insurer and is production based.
- Insurer contracts are validated annually through minimum production requirements.
- MGA's that do not have an MGA contract with a certain Insurer yet would like access to that Insurer's products may sign an AGA or a corporate contract with an MGA that is contracted with that Insurer subject to certain terms and conditions.
- Agencies that do not have any MGA contract and would like access to certain Insurer's products may sign an AGA or a corporate contract with one or more MGA's subject to certain terms and conditions.
- An Advisor or Insurance Agency (with some insurers) may have a direct contract (Agency Agreement) with some insurers. The direct contract with the Insurer would not involve an MGA. Details of this type of operation are not covered in this Report.
- The volume and size of both submitted and in force business would vary a great deal from one MGA to another depending on the size of the MGA but business policy submission standards and in force policy management processes are set by the Insurer and would not vary particularly from one MGA to another.
- MGA Licensing and Corporate E&O requirement in some provinces

An MGA is a conduit that facilitates business between the Advisors, their clients and Insurers. An MGA brings the following value proposition:

- Processing and tracking advisors' business submitted by Advisors through the MGA
- Directly provide Advisors sales support
- Provide Insurers access to Advisors so the Insurer can provide sales support
- Pooling of commission payments for the Advisor from various Insurers
- The MGA facilitates the two way flow of pertinent information between the Insurer and the Advisor
- Pertinent Advisor information would include Advisor/Insurer contracting, licensing and E&O coverage
- Pertinent Advisor client information would include all client information required by the Insurer in connection with any particular piece of submitted business
- E&O Coverage is the Advisors responsibility
- MGA's may carry their own corporate E&O

### **Advisor/MGA Placement of Business**

- An Advisor may be contracted with more than one MGA and may place business with the MGA's with whom they are contracted
- All Advisor business with any one Insurer must be placed with the same MGA which is tracked by the MGA, Insurer and Advisor through the Advisor code.

### **MGA Description – Size of Operation**

- An MGA may be centralized and operate from a single location
- An MGA may be more decentralized and operate from multiple offices in the same Province
- An MGA may have offices in more than one Province
- An MGA may be National and be licensed and operate in all Provinces

### **MGA's and Advisor Recruiting**

The MGA actively recruits new and existing Advisors to their organization. Some MGA's will assist new recruits to follow a process wherein they are assigned to an experienced Advisor for mentoring and on the job training.

- Experienced Recruits may be recruited from either a career Insurer or another MGA
- There are industry processes in place to assist the MGA new Advisor screening process
- Regulatory Criteria -The newly recruited Advisor must be 'in good standing' with respect to the Life industry with license, E&O coverage and Insurer contracting
- It is important to note that the final check resides with the Insurer and whether they are prepared to contract with the new MGA recruit

### **Licensing and Monitoring**

- Independent Advisor licensing is a provincial jurisdiction.
- MGA's verify that Advisors renew their license annually or bi-annually as required.
- MGA's verify that Advisors carry E & O (Errors and Omissions Insurance) as required by provincial regulation.
- MGA's either maintain databases containing licensing and E & O records or have access to these databases.
- Any and all Advisor submitted business is checked for accuracy and completeness by the MGA.
- Outstanding underwriting requirements by the Insurer are tracked and followed up by the MGA.



## **Contracting**

- The MGA supports and assists the Advisor in obtaining contracts with those Insurers with whom they wish to place business.
- The MGA facilitates the submission of completed contracting requirements between the Advisor and the Insurer.
- Advisor contracting with an Insurer is not product specific – the Advisor is contracted for the Insurer's entire product line.
- Insurer/MGA contracts can vary from Insurer to Insurer (non Standard)
- With most Life companies the contract between the Advisor and the Insurer only goes into effect with the first piece of submitted and accepted and placed business. Note: This clause is not contained in the Insurer contract.
- In MGA/Advisor contracting, MGA's perform Advisor background checks. Note: Smaller MGA's may rely on the Insurers' background check.
- In Advisor/Insurer contracting, the Insurer performs Advisor background check.

## **On-Going Training**

MGA's are active in assisting the Independent Advisor with obtaining of CE credits and training. The MGA also acts as a conduit to provide Insurer and Professional Designation organizations access to their Independent Advisors. The MGA actively supports professional designation organizations to provide extra learning to Advisors.

- Product
- Practice Management
- Sales Training
- CE Credit Management is the responsibility of the Advisor and is subject to audit by either/both the MGA and the Insurer, the Regulator and professional designation issuer.

## **Business Conduit**

The MGA works as a conduit between Advisors and Insurers so that full information on applicants is provided to Insurers. This information is provided for underwriting decisions to be made. The MGA also relays information between the Insurer and Advisor for timely and accurate In Force business management. All new and in force policies are contractual agreements between the insured (customer) and the Insurer.

- New Business policy placement
- In Force Business management

## **Compensation**

The MGA acts as a conduit between the Insurer and Advisor for timely and accurate new and renewal commission management.

- Advisor Insurance commissions are paid by the Insurer directly to the Advisor
- Electronic FundServ Segregated Fund commissions are paid to the Advisor by the MGA
- Paper Based Segregated Fund commissions that are submitted directly to the Insurer are paid to the Advisor by the Insurer
- Advisor compensation is negotiated between the Advisor and the MGA
- Charge back commission is the responsibility of the Advisor and if not dealt with within a predetermined timeframe is absorbed by the MGA and then the MGA initiates the commission recovery process with the Advisor

## **Market Conduct**

### **Sales Practices**

#### **Advisor Disclosure Form to Consumers/Customers/Clients**

- This is an Industry led standard that is applied uniformly across the country ensuring Advisors meet regulatory objectives and provide more consistent and complete disclosure to consumers.
- Financial Advisors are expected to use a disclosure statement that is appropriate to their business model and their own unique circumstances.
- The Form can be part of the product application of some Insurers and identifies the Insurer the Advisor represents. In most cases it is a separate document disclosing the companies the Advisor represents and the nature of relationship with these companies and is provided to the consumer.
- Disclosure Form content also includes information on how the Financial Advisor is paid, any conflicts of interest and that the Financial Advisor may be eligible for additional compensation such as travel incentives based on other factors. (Volume of business for example)
- In signing the product application the customer confirms their receipt of the Personal Disclosure Form which the Advisor also confirms by signing the Product Application.
- Product suitability – The product recommended must be suitable to the consumer and is the responsibility of the Advisor.
- Larger MGA's have a compliance department. The compliance department works closely with Insurer compliance departments in the event of a client complaint.

## **Insurer Relations**

The MGA acts as a conduit between the Advisor and Insurer in the areas of:

- Coordination of new business submission and settlement
- In force business servicing requirements
- New product introduction and training.
- Existing product training meetings
- Regulatory updates
- Compensation and contracting
- Insurers (e.g.) Sun Life and Manulife perform MGA and Advisor audits. (Content – CLHIA)

## **Complaint Management**

- The Insurer controls the complaint process.
- The MGA assists in the complaint management process.
- The contract (Policy) is between the client and the insurer
- As a point of differentiation between MGA and MFDA complaint management, it is Mutual Fund Dealer/ Advisor that is generally the focal point of the complaint and as a result Dealer regulatory capital is a requirement.
- As a point of differentiation between MGA and MFDA governance, MFDA is deeply rules based while MGA governance is principles based.
- Client complaints begin with the Insurer and then are relayed through the MGA to the Advisor. The MGA would facilitate the process and the Insurer would respond to the client.

## **Report Summary**

The Report has been prepared for the CCIR Agency Regulation Working Group with the goal to provide a better understanding of MGA operations and to assist as well, in the regulatory review process. Recommendations and Report content suggestions were also provided to CAILBA by CLHIA, Advocis and IFBC. It is recognized that there are areas within the Report that overlap with areas of each of these organizations. As such, CLHIA, Advocis and IFBC may choose to provide their own submissions to the CCIR Agency Regulation Working Group.



**Canadian Life  
and Health Insurance  
Association Inc.**

**Association canadienne  
des compagnies d'assurances  
de personnes inc.**

## **Managing General Agencies and the Distribution of Life Insurance**

**A Report to the Canadian Council of Insurance Regulators  
Prepared by the Canadian Life and Health Insurance Association**

*June 2010*

1 Queen Street East  
Suite 1700  
Toronto, Ontario  
M5C 2X9

Tel: (416) 777-2221  
Fax: (416) 777-1895  
[www.clhia.ca](http://www.clhia.ca)

1, rue Queen Est  
Bureau 1700  
Toronto (Ontario)  
M5C 2X9

Tél.: (416) 777-2221  
Fax: (416) 777-1895  
[www.accap.ca](http://www.accap.ca)

**Toronto • Montreal • Ottawa**

# **Managing General Agencies and the Distribution of Life Insurance**

## **Executive Summary**

Although it is relatively new in Canada, the Managing General Agency or MGA channel has recently emerged as the largest distribution channel for life and health insurance, accounting for just over one-third of all new premiums.

The functions that life and health insurance companies delegate to MGAs vary from company to company and from MGA to MGA. In fact, a single insurer may delegate different functions to different MGAs.

Insurers may delegate to MGAs a variety of specific functions related to screening and/or monitoring agents. In all cases, the insurer remains accountable for ensuring that the delegated functions are handled properly.

The functions an insurer chooses to delegate to an MGA are set out in a contract between the insurer and the MGA. This agency agreement also provides a means for the insurer to assess the MGAs handling of these functions on an on-going basis.

Generally, insurers expect MGAs to have written policies and procedures in place to handle any delegated function.

The MGA channel encompasses a wide variety of business models ranging from large, national organizations to small, local operations. Despite the absence of a clear and consistent description of how the channel operates, there is no evidence of systemic problems in the channel.

## **Managing General Agencies and the Distribution of Life Insurance**

### **About CLHIA**

Established in 1894, CLHIA is a voluntary trade association that represents the collective interests of its member life and health insurers. Our members account for 99 per cent of the life and health insurance in force in Canada and contribute to the financial well-being of millions of Canadians by providing a wide range of financial security products.

The industry protects 26 million Canadians, as well as 19 million policyholders in other countries around the world, with products such as life, health and disability insurance as well as savings and lifetime income solutions, including segregated funds and annuities. It also administers two-thirds of Canada's pension plans, primarily Defined Contribution (DC) plans for small and medium-size businesses.

In 2008, Canada's life and health insurers paid out \$58.4 billion in payments to policyholders and beneficiaries.

### **Emergence of the MGA Channel**

Over the years, the distribution of life insurance has undergone considerable diversification. Along with the traditional career agent or exclusive sales force, life insurers might now use any combination of independent agents, Managing General Agencies (MGAs) and national accounts to distribute their products. Each of these major distribution channels is further divided into sub-categories. So independent agents may be either individuals working on their own or Personal Producing Groups of Agents (PPGAs), MGAs include Associate General Agencies, and national accounts include both IIROC dealers and MFDA dealers.

In terms of volume of new business, the MGA channel has recently emerged as the largest. According to Investor Economics, between 2003 and 2007, the dollar value of new premiums in this channel increased by 50% so it now accounts for just over one-third of all new premiums.

Estimates of the number of MGAs vary, in part because the concept is not consistently defined. Investor Economics estimates there are upwards of 400 agencies in Canada, of which approximately 100 are what it calls “bonafide” MGAs.

The reasons for the emergence of this channel are probably as varied as the number of MGAs and insurers using them. Certainly at the beginning, insurers operating career sales forces were, at least in part, motivated by the economies of shifting to a distribution channel that reduced their exposure to fixed costs and overhead. As individual MGAs grew and evolved, however, many have acquired specialized expertise for product lines, markets or distribution techniques that has enhanced their value for both insurers and agents.

### **Description of Report**

This report relates solely to the sale of individual life and health insurance in the MGA channel. The description of practices in this report may not apply to other types of insurance (e.g., group life or property and casualty) sold by MGAs or to other entities selling individual life and health insurance.

For the convenience of the reader, throughout this report the terms “insurance” and “life insurance” refer to individual life and individual health insurance unless explicitly stated otherwise.

The specific functions described in this report include all those that may, in theory, be delegated by a life insurance company to an MGA. In reading this account, it is important to bear in mind that there is considerable variability within the industry in terms of what individual companies actually delegate in practice. Some companies operating within the MGA channel may delegate most or all of these functions while others delegate very few, if any. What is more, companies that delegate may build a degree of redundancy into their model by also carrying out the function. Finally, a company may delegate a function to some MGAs and carry out that same function itself when dealing with other MGAs.

The functions of a typical MGA fall under three general categories:

- back office support between advisor and insurer for sales transactions
- sales and marketing support for the advisor
- market conduct compliance support for the insurer

This description of the MGA channel will focus on the compliance support that MGAs provide to insurers.

### **Basis for Compliance Functions**

The responsibilities of MGAs may be either statutory or contractual. Due to the types of products and the nature of transactions they handle, MGAs must monitor compliance with several statutory requirements that apply directly to them. Examples of these include, at the provincial level, licensing requirements and, at the federal level, privacy legislation and anti-money laundering and anti-terrorist funding legislation.



The other basis is contractual. MGAs enter into contracts with life insurance companies to act as intermediaries between the insurer and the agent. The terms of this contract, hereafter referred to as the “agency agreement”, will specify functions that the insurer expects the MGA to perform.

Either as a matter of sound business practices to manage reputation risk or to comply with statutory requirements, insurers need to be aware of the conduct of agents contracted to represent them. The practices that insurers use to assess an agent prior to entering into a contract (i.e., screening) and to keep tabs on on-going sales conduct (i.e., monitoring) are described in CLHIA Guideline G8 *Screening Agents for Suitability and Reporting Unsuitable Agents*. An insurer may delegate some or all of the screening and monitoring practices to a third-party such as an MGA. If an insurer chooses to delegate any of these practices to an MGA, the delegation and any related responsibilities will be set out in the agency agreement.

While insurers may delegate specific functions, they are not able to delegate responsibility for these activities. Thus an insurer will, as a matter of due diligence prior to entering into an agency agreement, assess the ability of the MGA to carry out the delegated functions. As well, the agency agreement will provide a means for the insurer to assess the MGA's capacity and performance with respect to delegated functions on an on-going basis.

It should be noted that an exception to the foregoing description of accountability arises in Quebec. There the functions of manufacture and distribution, along with related accountabilities, are separated by statute.

### **Contracting with MGA**

Prior to deciding whether to enter into an agency agreement with an MGA, an insurer, as noted above, will consider the capability of the MGA to carry out

any functions delegated to it. Further, insurers will also typically look for evidence of the soundness of the MGA (e.g., financial statements, debts owing to other insurers and business plans), the background of principals involved in the organization and business references.

### **Screening Functions**

To assist the insurer in determining whether or not to enter into a contract with an agent, the insurer may ask an MGA to obtain some or all of the following types of information about the agent:

- background and reference checks
- credit checks (including bankruptcy history)
- confirmation of prior work or business experience
- debt to other insurers and industry participants
- history of market conduct in financial services
- confirmation of licensing
- confirmation of Errors & Omission insurance coverage

As part of its initial and ongoing due diligence, insurers will assess the MGA's documented policies and procedures related to any of these checks. This is done to ensure the MGA's standards meet or exceed those of the insurer. Generally, policies and procedures will include prescribed actions for addressing any identified deficiencies in the agent and any provision for exceptions.

### **Monitoring Functions**

To assist the insurer in assessing the on-going suitability of an agent, the insurer may ask an MGA to obtain some or all of the following types of

information about the agent and transactions done by the agent on behalf of that insurer:

- holding out as a life and/or A&S insurance agent
- use of needs-based sales practices
- protection of personal information
- representations and advertising standards, including websites
- unfair trade practices
- rules governing the replacement of life insurance policies
- misrepresentation
- handling of cash or cash equivalents
- garnishments against representatives
- conservation/persistency
- debt in the representative's account
- bankruptcy or insolvency of the representative
- management of conflict of interest including disclosure

In addition to this information, the insurer may ask the MGA to verify on an on-going basis (for example, with the submission of each application for insurance) that the agent has a valid licence and E&O insurance.

### **Complaint Handling Functions**

From the consumer perspective the MGA is typically the least visible partner in the transaction so consumer complaints are most likely to go to either the agent or the insurer. (Note that the OmbudService for Life & Health Insurance will generally refer a customer to the insurance company as a first step in resolving a dispute.) Complaints about an agent by another agent may go to the MGA.

Insurers typically require the MGA to:

- advise the insurer of any complaints about its products or the conduct of agents as it relates to its products
- advise the insurer of evidence of probable misconduct in relation to the insurer's products
- have a process to inform the insurer of investigations by either a regulator or the MGA that find the agent contravened regulations, rules or applicable codes of conduct
- have policies and procedures that require agents to inform the MGA of client complaints and regulatory inquiries or investigations
- have procedures for communicating standards of conduct to agents

Once an insurer receives or becomes aware of a complaint related to the handling of one of its products, the insurer will generally handle the situation on its own. An insurer may, however, seek the involvement of an MGA in handling specific aspects of the case.

If it becomes necessary to report to the regulators that an insurer's agent is unsuitable, the insurer will submit the report. This reporting function is generally not delegated. An MGA may, however, report to regulators on the outcome of any investigation it conducts on its own behalf.

### **Policies and Procedures Related to Legislative Requirements**

As a matter of initial and ongoing due diligence, insurers will seek to determine that MGAs involved in handling their business understand and are capable of complying with applicable legal responsibilities.

Accordingly, insurers typically expect an MGA to have written policies and procedures related to legislative requirements applicable to the life insurance transactions that the MGA has a part in handling. This includes but is not

limited to requirements related to privacy, anti-money laundering and anti-terrorist financing.

In addition to written policies and procedures, insurers expect MGAs to have:

- related training programs for agents and employees
- policies and procedures for dealing with breaches (including notification to the insurer)
- an assessment of AML/ATF risk and measures to mitigate high risk
- procedures for reporting suspicious and attempted suspicious transactions

## **Training**

Where an insurer has delegated responsibilities to an MGA and requires the MGA to have policies and procedures related to that function, insurers will generally expect the MGA to provide adequate training or other communication so that agents and employees are familiar with the policies and procedures.

In addition, to provide value for its agents, many MGAs will provide training on sales and marketing techniques or business practices. As well, they may provide general information that is related to insurance or financial services. For example, if new tax laws go into effect that agents will need to explain to their clients, the MGA may provide information or arrange a workshop.

With respect to information about products, some MGAs may provide basic product category information. Otherwise, insurers generally want to meet face-to-face with agents to explain their products. Beyond ensuring the accuracy and completeness of information about their products, this sort of meeting provides an opportunity to build relationships and address other issues that may otherwise go unnoticed.

If an agent has questions about a product or its suitability for a particular client, agents are expected to consult directly with insurers. Because MGAs may handle the products for a number of insurers, it is not reasonable for them to possess the detailed knowledge that would be necessary to handle most questions about a specific product.

Beyond the responsibility of an agent to recommend products that are appropriate to the needs of the client, the actual process of underwriting typically rests exclusively with the insurer. While the agent and, in some cases, the MGA may offer additional information to assist this process, final decisions as to the suitability of the risk are made by the insurer and its underwriters, using approved standards to make these decisions. The insurer's underwriting decision is final and cannot be changed by the MGA or agent.

### **Compensation**

The MGA receives its compensation in the form of an override from the insurer.

The insurer pays first year commissions and renewal fees (or permanent commissions) directly to the agent. The insurer calculates an override as a percentage of the first year commission and pays this to the MGA. The MGA, in turn, then pays a share of the override to the agent. The specific share of the override is determined by the MGA and may vary substantially from one MGA to another.

## **Regulation of MGAs**

Generally, the core business functions of an MGA (i.e., soliciting insurance and/or transmitting an application for insurance) mean that either the agency or its principals will need to satisfy provincial insurance licensing requirements and other related requirements, including the requirement to have errors and omissions insurance. In addition, the nature of the MGA's business means it is subject to statutory requirements related to privacy, money laundering and terrorist financing.

Beyond this direct regulation, additional regulatory requirements on insurers are indirectly applied to MGAs by way of agency agreements. In other words, regulatory requirements imposed on insurers may be contractually imposed on an MGA if the insurer delegates specific actions to the MGA.

None of these requirements are unique to MGAs. The recent emergence and growth of the channel raises the question of whether the existing regulatory structures need to be complemented by structures specific to the channel.

In response to this question, it should be noted that there is no clear evidence of systemic problems in the channel. Over the past year, CLHIA has been presented with anecdotal evidence of specific incidents but these appear to be isolated and often do not relate directly to MGAs. This apparent confusion underscores the lack of clarity about the channel, a situation that this description is intended to address.

## **OSFI Requirements**

In June 2005, OSFI released a memorandum explaining the importance of effective reputation risk management. To underscore the difficulty of predicting and quantifying reputation risk, the note explained that it can arise

due to inadequate management of virtually any aspect of an insurer's operations and that it can arise even when transactions technically comply with legal, accounting and regulatory requirements. In the case of managing reputation risks associated with agents contracted to represent the insurer and its products, this appears to acknowledge that agents and the insurer may be held to a higher standard than minimum statutory requirements.

The OSFI note calls on insurers to utilize effective practices to manage reputation risk on an ongoing basis and establishes that boards and senior management are ultimately responsible for ensuring that effective risk management practices are in place. Among other things, insurers should have policies that establish a framework for managing reputation risk on an on-going basis and have procedures for monitoring the effectiveness of risk management practices and providing regular reporting to senior management and the board.

In addition, CCIR has asked specifically about the applicability of the materiality test in OSFI Guideline B-10 *Outsourcing of Business Activities, Functions and Processes*. It is not clear if Guideline B-10 applies to the delegation of screening and monitoring functions to MGAs as Annex 1 of that guideline specifically exempts sales of insurance policies by agents and brokers. If B-10 does apply, it is not clear that the relationship between an insurer and a specific MGA would be assessed as being material. Insurers seldom operate exclusively within the MGA channel and, for the business that is conducted in that channel, insurers have the option of using any of several MGA firms. For these reasons, an insurer's exposure to a particular MGA will generally be non-material.



## **Other Matters Raised by CCIR**

Over the past several months, CCIR has asked specific questions about the MGA channel and related matters. Some of these fall outside the scope of the general account provided in this report and are dealt with below.

### Claims and Premium Administration

Generally MGAs are not engaged in either of these processes. For some specialized insurance products such as travel insurance, insurers may outsource portions of the claims process but this is not typically outsourced to an MGA unless a specific MGA happens to offer this service. In the case of premiums, life insurance premiums are payable directly to the insurers.

### Insurance Packages

MGAs do not generally develop insurance packages for clients and shop these around to insurers. In fact, in most cases, MGAs never deal directly with retail customers. In dealing with a client, an agent will typically conduct a comprehensive needs analysis and recommend specific products, frequently from different insurers, to meet specific needs. These recommendations may be presented to the client as a plan or package. If a recommended product is not acceptable to a client, for one reason or another, the agent may then try to find an alternative.

### Integrity of Information

Generally the MGA acts as a conduit, assisting the agent in transmitting information to and from the insurer. An MGA may house the client files of agents contracted with the MGA but any information necessary to verify a client's insurance will be housed by the insurer where all reasonable measures are taken to safeguard proof of coverage.



**Advocis**  
390 Queens Quay West, Suite 209  
Toronto, ON M5V 3A2  
T 416.444.5251  
1.800.563.5822  
F 416.444.8031  
[www.advocis.ca](http://www.advocis.ca)

March 22, 2010

Agencies Regulation Committee  
Canadian Council of Insurance Regulators  
5160 Yong Street, P.O. Box 85  
Toronto, ON M2N 6L9

and to:

Canadian Insurance Services Regulatory Organizations (CISRO)

Dear Agencies Regulation Committee Members:

**Re: Financial Advisors and Managing General Agencies**

Advocis would like to provide its comments to the Agencies Regulation Committee of the Canadian Council of Insurance Regulators (CCIR) and to the Canadian Insurance Services Regulatory Organizations (CISRO) on the Managing General Agencies (MGAs) distribution channel from the perspective of the financial advisor. We will describe the roles, responsibilities and obligations of the financial advisor who is contracted with an MGA.

Advocis, The Financial Advisors Association of Canada, is the largest and oldest professional membership association of financial advisors and planners in Canada. Our association was founded in 1906, as the Life Underwriters Association of Canada.

Our almost eleven thousand members across Canada provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans and disability coverage, to millions of Canadian households and businesses. Our members are provincially licensed to sell life and health insurance and mutual funds and other securities. Advocis members are for the most part independent owners and operators of small businesses, entrepreneurs who create thousands of jobs in every community across Canada. Advocis members maintain lasting relationships with their clients based on trust. They help clients, young and old, individuals, families and businesses, to set financial goals, manage risks, save consistently and invest prudently.

It is our understanding that the Agencies Regulation Committee is at the fact-gathering stage of its process and is seeking to better understand the MGA distribution channel and the roles and responsibilities of insurers, MGAs and financial advisors to determine if there are any regulatory gaps which could lead to risk to consumers. We are pleased to work with the CCIR Agencies Regulation Committee on this important initiative.

## **Definition and Role of MGA**

An MGA is an incorporated entity in the distribution channel that enters into brokerage general agreements with an indeterminate number of insurers.

The MGA's contractual relationships with insurers are production based (based on the volume of business placed with that insurer).

MGAs provide advisors with an efficient method of contracting with an indeterminate number of insurers. Advisors also see value in contracting with MGAs as it often allows them to obtain better compensation arrangements than they could obtain if they dealt directly with an insurer.

Advisors also choose to be associated with an MGA as some MGAs also perform certain back-office functions such as compensation management services. An MGA may also provide administrative or sales support to the financial advisor (e.g., scheduling client meetings, renewal reminders, and product information.)

Advisors often deal with more than one MGA in order to obtain the coverage that is most appropriate for the consumer<sup>1</sup>. Insurers often contractually require an advisor<sup>2</sup> to place all business with that insurer through one MGA (for example, Insurer A requires that all business with Advisor A is placed through MGA A while Advisor A's business with Insurer B is placed through MGA B). Business is tracked by the MGA, insurer and advisor through the advisor's code.

### ***Advisor's Contractual Relationship with an MGA***

Financial advisors are independent contractors and can be associated with an indeterminate number of MGAs. Many financial advisors are associated with more than one MGA. The terms of the contractual arrangements between the advisor and the MGA may materially affect the advisor's ability to transfer their business from one MGA to another, should they wish to do so. The MGA will usually undertake an assessment before entering into a contractual arrangement with a given advisor that could include:

- reviewing the advisor's previous work experience
- reviewing the advisor's current book of business (i.e., potential sales productivity)
- assessing fit within corporate culture
- interviewing the advisor and
- ensuring that the advisor is a licensee "in good standing" – verify that license has been renewed and not suspended or revoked, verify that advisor has the required error & omissions insurance, and perform a credit check on the advisor.

The insurer then enters into a direct contractual relationship with the advisor. The MGA provides the contractual documentation of the insurer to the advisor and coordinates the process of the advisor contracting with the insurer. In addition, the advisor and the MGA enter

---

<sup>1</sup> Most MGAs do not require the advisor to deal exclusively through only one MGA although an MGA can contractually require exclusivity.

<sup>2</sup> Advisors may operate through separate legal entities so Advisor Company A may place its insurance business with Insurer A through MGA A while Advisor Company B may place its insurance business with Insurer A through MGA B.

into a written contractual agreement outlining the terms of their relationship including compensation.

### ***Oversight of Insurance Application by MGA***

The MGA will often perform oversight of the insurance application. MGAs may check advisor attestations on client applications for life and health insurance, and check the client application for completeness so that it is in good order prior to sending it to the insurer. If there are underwriting requirements of the insurer that are outstanding, the MGA will monitor those and follow up with the advisor and the insurer to see that they are dealt with appropriately and expeditiously instead of the insurer having to communicate directly with the advisor.

### ***Continuing Education/Training***

In addition to fulfilling their initial proficiency requirements (the LLQP), advisors obtain training, support and on-going continuing education throughout their careers in order to stay up-to-date with industry developments and regulatory requirements and in order to satisfy ongoing educational requirements.

The advisor may choose from various continuing education providers in order to obtain the continuing education credit hours that he or she needs to maintain their license in good standing, and as a matter of good professional development.

The advisor will be informed by the insurer about existing or new products. The MGA may arrange insurer seminars or other events at the MGA's office.

Some MGAs will offer CE courses themselves or will coordinate with CE providers to offer CE courses.

The advisor may receive marketing and sales training from the MGA or from the insurer, which may be arranged by the MGA.

### ***Compensation***

The advisor receives commissions (except with respect to electronic fundserv segregated fund commissions) directly from the insurer. At the direction of the MGA, the advisor may also receive a portion of the MGA's override directly from the insurer.

The advisor also receives compensation directly from the MGA pursuant to his or her contractual arrangement with the MGA. The MGA may utilize the insurer's compensation systems to make these payments.

### **Role of the Financial Advisor**

The obligations of the financial advisor to the client are the same irrespective of whether the advisor is associated with an MGA or not. The financial advisor is responsible for the appropriateness of the product recommendation made to the client.

In addition, the same licensing requirements are applicable to all insurance agents, regardless of whether they are associated with an MGA.

## ***Provincial Insurance Act and Associated Regulations***

All life insurance agents are subject to the province's *Insurance Act* and associated regulations, along with any provincial insurance council or provincial commission's rules or by-laws.

The Joint Forum in 2005 released a document entitled *Principles and Practices for the Sale of Products and Services in the Financial Sector*. The purpose of this document was to set out best practices for the conduct of all financial intermediaries in their dealings with consumers of financial products and services, and to provide consumers with a benchmark to assess the conduct of any financial intermediary with whom they currently have a relationship, or are considering establishing a relationship. Securities and insurance regulators across Canada unanimously endorsed this approach.

The eight principles and practices outlined by the Joint Forum in the paper are:

1. Interests of the Client
2. Needs of the Client ("Know Your Client")
3. Professionalism
4. Confidentiality
5. Conflicts of Interest
6. Disclosure
7. Unfair Practices, and
8. Client Redress.

The principles and practices are embodied in industry codes of conduct and are implemented through the insurance regulators' principles based approach to regulation.

All life insurance products, including the marketing and sale of segregated funds, are subject to the three key principles for managing conflicts of interest established by the Industry Practices Review Committee (IPRC) of the Canadian Council of Insurance Regulators (CCIR) and the Canadian Insurance Services Regulatory Organization (CISRO) in 2006:

1. priority of client's interest – an insurance intermediary (broker or agent) must place the interests of insurance policyholders and prospective purchasers ahead of his or her own interests;
2. disclosure of conflicts or potential conflicts of interest – consumers must receive disclosure of any actual or potential conflicts of interest associated with a transaction or recommendation; and
3. product suitability – the recommended product must be suitable to the needs of the consumer.

All life insurance agents are required to adhere to the above-noted three principles in respect of each recommendation made to a client in order to appropriately manage conflicts of interest.

In addition, agents when selling segregated funds are required to follow the steps set out in the CLHIA Guidelines on IVICs which has been endorsed by the CCIR. "These steps include delivery of the Information Folder and will include compliance with revised point of sale requirements as set out by the Joint Forum in *Proposed Framework 81-406: Point of sale disclosure for mutual funds and segregated funds* (the "Framework").

The CCIR is in the process of implementing the Framework by establishing revised point of sale disclosure standards for segregated funds, which include the delivery of the Key Facts and Fund Facts point of sale documents to clients. Advisors will be providing this disclosure to consumers.

### ***Product Suitability***

The IPRC's product suitability principle is that "*the recommended product must be suitable for the needs of the consumer*". The IPRC stated that it expects brokers and agents will explain to their clients and document the reasons for recommending a particular product. The recommendation should be based on the following:

- Fact finding appropriate to the circumstances, and assessment of the client's specific needs;
- A flexible needs assessment. The assessment should reflect factors including the underlying risk, the client's objective, and the complexity of the product being sold; and
- An agent or broker's product recommendation that meets the client's identified needs.

In order to develop best practices for intermediary disclosure, Advocis participated in the Intermediary Disclosure Working Group (along with the Canadian Life and Health Insurance Association (CLHIA) and other industry associations). The Working Group produced the "*Advisor Disclosure Reference Document*" in March 2005.

Advocis worked with other industry participants, including the CLHIA and CAILBA to standardize the needs-based sales practices that are integral to the product suitability principle, through the production of the reference document: *The Approach: Serving the Client Through Needs-Based Sales Practices*.

Advocis also developed its own Best Practices Guideline on Product Suitability along with an interactive web-based tool entitled "*The Advocis Interactive Disclosure and Product Suitability Web Tool*". This helps advisors to generate transaction and recommendation disclosure letters based on the *Advisor Disclosure Reference Document*. The letters can be customized for clients in all provincial jurisdictions. In the disclosure letter, agents disclose the companies they represent, the financial relationships they may have with those companies and whether an actual or potential conflict of interest exists. Moreover, the tool has a product suitability component that outlines the process that the advisor has gone through in making the recommendation, which can be reviewed and signed off by the client.

The three key principles of the IPRC, including product suitability, apply to all life & health insurance products including segregated funds. The agent must apply the principles for each product recommendation he or she makes irrespective of whether they are a career advisor, independent advisor or an advisor who operates through an MGA.

### ***Documentation/Retention***

The advisor must keep appropriate documentation to ensure compliance with all regulatory requirements and should, as a best practice, retain in the client file a written account of the steps taken to ensure priority of the client's interest and product suitability. Accordingly, the client file should contain: information gathered from the client; the needs assessment analysis;

copies of the engagement letter; product comparison information presented to the client; intermediary disclosure documents addressing conflicts of interest and any formal suitability statements or letters presented to the client. These requirements form part of Advocis' best practices advice to its members on how best to apply the IPRC's principles for the sale of insurance.

Insurance companies monitor their intermediaries through spot audits using a risk-based approach. Spot audits by the insurance company would include checking that advisors have properly documented a given product recommendation and disclosures regarding conflicts of interest.

### ***Proficiency, Continuing Education and Errors and Omissions Insurance Requirements***

Regulatory requirements also include provincial licensing requirements for insurance agents in order to act as an "agent" in a given province, including initial proficiency and continuing education requirements. An applicant must complete the Life License Qualification Program (LLQP) and examination in order to be eligible to be licensed to sell life insurance products (including segregated funds) and is also required to complete a certain number of continuing education credit hours (CEC's) in each license year (except the Atlantic Provinces).

The advisor is responsible for meeting their obligations with respect to earning CE credits. The obtaining of credits may be audited by the provincial regulator.

In order to sell life insurance (including segregated funds) insurance agents are also required to carry errors and omissions insurance (except in the province of PEI). Proof of errors and omissions insurance coverage must be submitted to the regulator by the advisor in order for their license to be renewed. MGAs ask advisors to submit a copy of their errors & omissions certificate and may stipulate a certain amount of errors and omissions coverage (what is required in accordance with applicable provincial regulations) in the contract with the advisor. Many back office systems in use by MGA's will, when submitting a new application for insurance, check for current errors and omissions coverage and to confirm that the license is current. If the license is not current then the application will be returned. If the errors and omissions coverage has expired, then a pending requirement is established for current proof of errors and omissions coverage.

## **Insurer Responsibilities**

### ***Agent Suitability***

Provincial regulations require insurers to establish and maintain a system that is reasonably designed to ensure that each agent complies with the Act, the regulations and the terms of the agent's license. This includes screening the agent for suitability to carry on the business as an agent (for example, see section 12 of Ont. Reg. 347/04). Insurance companies are required to monitor an agent's suitability and conduct as a licensee.

Insurance companies ensure that financial advisors follow acceptable sales practices in such areas as replacement disclosure, conflict of interest disclosure and product suitability through spot audits using a risk-based approach.

Some provinces (such as Ontario) do not require insurers to sponsor the advisor once certain experience requirement levels are met (2 years) whereas other provinces (such as New Brunswick) require an insurer to sponsor the agent for an indefinite period of time. Other provinces (such as British Columbia) require the insurer to provide a certification in respect of the agent but do not require any exclusivity. It is the insurer's responsibility to meet its sponsorship obligations. The MGA may assist the advisor in finding an insurer to be his or her sponsor.

## **Consumer Complaints**

If the advisor receives notice of a potential or actual claim (a verbal or written demand for compensation) arising from an alleged error, omission or negligent act of the agent, then the agent is obligated to report the potential or actual claim to the errors and omissions insurance carrier.

If the advisor receives a complaint from a client about the insurer, the advisor will advise the client to contact the insurance company as each company will have a procedure to deal with a consumer complaint. The advisor will assist the client in the process if the advisor determines that the client has a legitimate complaint. If the advisor determines that the complaint is not legitimate, the advisor will explain to the client what process the client must follow in order to proceed with his or her complaint.

The advisor will also notify the MGA and insurer of any complaint regarding the advisor, the MGA or the insurer that the advisor directly receives from the client. The advisor has a contractual obligation through its errors and omissions policy to notify its errors and omissions carrier.

## **Compliance with Federal Legislation**

### ***Anti-Money Laundering and Anti-Terrorist Financing Regime Obligations***

Various records must be kept in order to comply with the federal Anti-Money Laundering (AML) and Anti-terrorist Financing legislative scheme. Advocis worked extensively in cooperation with FINTRAC to develop course materials and best practices to implement AML guidelines.

In August 2007, Advocis released a guide to advisor obligations under the federal government's anti-money laundering and anti-terrorist financing regime which had recently undergone significant changes. Advisors also may access a guide in the Advocis Best Practices Manual, as well as a continuing education eligible training module.

As of June 2008, all reporting entities (as defined under the AML legislation) are required to conduct an assessment of the money laundering and terrorist financing risks in the course of their business activities. Advisors are required to make a subjective assessment of whether a client represents a heightened risk, taking into account the type of customer, the type of product, the delivery channels, geographic location and other such key factors. A best practice for a risk assessment for an advisor's business is to perform it in two stages: Stage 1: business-based risk assessment of products, services, delivery channels and the geographic location business is conducted and Stage 2: client and business relationships.



FINTRAC Guideline 4 and checklists assist with the process. The advisor therefore assesses risks for money laundering and terrorist financing according to a combination of individual factors that have been identified for the advisor's specific business.

MGAs have policies and procedures in place to ensure that the MGA and its associated advisors are in compliance with Anti-Money Laundering and Anti-Terrorist Financing legislation in order to meet their regulatory obligations.

***Privacy Legislation and Do Not Call Legislation***

Financial advisors are also responsible for ensuring they comply with existing privacy legislation and Do Not Call legislative and regulatory requirements.

MGAs are also required to ensure they comply with privacy legislation and Do Not Call legislative and regulatory requirements.

We are pleased to provide the CCIR and CISRO with this information regarding the MGA distribution channel and specifically the advisor's role and obligation in relation to clients, insurers and MGAs. We would be pleased to discuss our comments with you in greater detail.

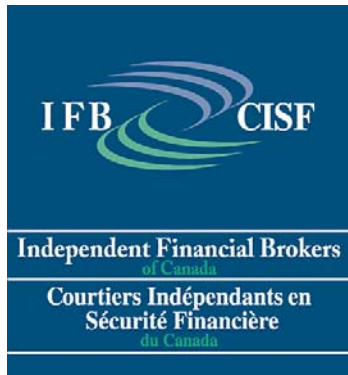
Yours sincerely,



Greg Pollock  
President and CEO



Terry Zavitz CFP, CLU, RHU, GBA, EPC  
Chair, National Board of Directors



30 Eglinton Avenue West, Suite 306  
Mississauga ON L5R 3E7  
Tel: (905) 279-2727  
Website: [www.ifbc.ca](http://www.ifbc.ca)

March 15, 2010

Carol Shevlin  
Policy Manager  
Canadian Council of Insurance Regulators  
5160 Yonge Street, Box 85  
Toronto ON M2N 6L9

Sent by email: [Carol.Shevlin@fSCO.gov.on.ca](mailto:Carol.Shevlin@fSCO.gov.on.ca)

Dear Ms Shevlin:

**Subject: CCIR Spring Meeting materials**

IFB has prepared the attached report on the role of insurance agencies in the distribution of life/health insurance products for consideration by the CCIR at its upcoming Spring meeting.

We understand that the role of the MGA is a topic of discussion at this meeting. IFB is pleased to offer our comments, on behalf of our 4,000 members, many of whom are licensed life brokers and therefore well acquainted with current business practices involved in the placement of insurance for consumers.

IFB is also a major provider of corporate errors and omissions insurance. The rise in agencies acquiring corporate errors and omissions insurance over the past few years means that our membership now represents a significant number of independent agencies which offer services to independent brokers. This alliance fits well with our mandate to support the independent sales channel.

The comments contained in our report reflect the views of individual brokers and insurance agencies and are based on a survey we developed for this purpose. We trust members of the

CCIR will find them useful in contributing to a more complete understanding of the interplay between brokers, agencies and insurers.

We would be pleased to offer further comment or participate in further discussion as you require and we wish you a successful meeting.

Sincerely,

A handwritten signature in black ink, appearing to read 'John Whaley', written in a cursive style.

John Whaley  
Executive Director  
Email: [jaw@ifbc.ca](mailto:jaw@ifbc.ca)

## **ROLE OF THE AGENCY IN THE DISTRIBUTION OF LIFE/HEALTH INSURANCE PRODUCTS**

Independent Financial Brokers of Canada (IFB) is pleased to provide the Canadian Council of Insurance Regulators (CCIR) with input on the current distribution framework and how it supports independent life/health insurance brokers and their clients. We trust that our input will help to address the questions regulators have posed and contribute to a deeper understanding of how this market functions.

### **PURPOSE OF SUBMISSION**

Questions have been raised by life/health insurance regulators on the role of insurance agencies in the distribution of life/health insurance products to consumers. The CCIR has identified an initiative in its “2008-2011 Strategic Plan” to review the regulation of managing general agencies (MGAs) and to identify any risks to consumers, regulatory gaps and legislative and regulatory barriers.

While no formal consultation is currently underway, industry stakeholders have been asked to provide a description of what constitutes an ‘agency’ and the types of activities it takes on to support the sales process. Over the past few months, IFB, CAILBA, Advocis and CLHIA have held various meetings to discuss how each of our member constituents interact and the responsibilities each has in ensuring consumers receive suitable advice and products. Together this group represents advisors, small agencies, MGAs and life/health insurance companies.

### **OUR CONSTITUENCY**

IFB represents some 4,000 independent financial advisors across Canada. The majority are life licensees. Our members must be independent, meaning they must be free to offer products from more than one provider. Most operate small financial services businesses in their local communities.

As well, many of our members are also principles of insurance agencies. These agencies may be AGAs, MGAs or smaller personal producing agencies. IFB being a major provider of corporate Errors and Omissions insurance has over 100 corporate members in our plan that look to us for representation in this matter.

### **IFB SURVEY**

In order to better understand the relationship of our individual and corporate members with the insurers and the insurance agencies they do business with, we conducted an online survey. There were two parts to the survey – one part designed for individual brokers to respond to and another part for those who are principles of an agency (i.e. an AGA or MGA).

The agencies represented in our survey results range in size from very small (under 5 brokers) to very large (over 1,000 brokers). About half, however, have less than 50 brokers under contract. This is significant for regulators because while CAILBA members represent a large percentage of life business conducted through MGAs, many of its members are larger corporate entities whose scope of operations can be very different than those of small or mid-sized agencies. Regardless of size each has a place in the distribution of insurance and on occasion may overlap. For example, an agency may have a MGA contract with certain insurers but need to place a broker’s business through a different MGA if the broker has selected an insurer that the MGA does not have a contract with. Alternatively, the broker may use a different MGA or agency in this regard.

This type of flexibility is welcomed by the brokers and agencies in our survey. MGAs add value by supplying business-to-business services that contribute to the sales process by providing administrative efficiencies. In contrast, brokers are at the forefront of the sales process because they establish, build and maintain the relationship with the consumer/policyholder.

### **SURVEY RESULTS**

About 400 individual members responded to our survey and 35 principles of insurance agencies. Most brokers are licensed in Ontario, although there were respondents from most provinces. Nearly 80% of the brokers have been licensed for more than 10 years.

Most agency respondents have offices in Ontario or in Western provinces. They tend to be small in size; almost 50% have fewer than 50 brokers under contract (15% have fewer than 10 brokers). However, 30% have between 100-500 brokers and 10% have more than 750 brokers.

### **Broker/ Agency relationships**

Regulators have asked us to describe the market function of agencies and how they interact with brokers and insurers.

In the current marketplace, life Insurance agencies can range in size from small offices supporting a few brokers, to large complex organizations which operate in multiple locations and offer a wide range of services. For example, larger agencies or MGAs may engage in a variety of business activities including training, marketing, and managing the service and claims functions, while smaller agencies may engage in only a small subset of these functions. However, the baseline business function agencies share in common is to provide services intended to increase the administrative efficiencies between the broker and insurer.

### Contractual relationships

Brokers are individually contracted with the insurers they place business with. This contractual relationship identifies the roles and responsibilities of each party and compensation agreements. In our survey,

- Many brokers are able to place business directly with the insurer (this is especially true for group insurance)
- The most common services brokers get from life companies are related to product training.

Brokers then may contract individually with an agency, as does the insurer. These contracts are generally aimed at simplifying certain administrative functions for the insurer and the broker. In our survey,

- Most brokers have contracts with multiple MGAs (up to 5)
- Many have contracts with local AGAs

We asked agency representatives to tell us what insurers commonly specify in their contracts. The most common items were:

- Requirement to adhere to the company's or industry code of conduct
- Provision of administrative support
- Management of compensation for brokers

We asked brokers to tell us the most important services that their agency provides to them.

- The 2 most important factors for brokers when choosing an MGA/AGA were the insurance companies the agency has contracts with and the level of service to be provided. Categories related to compensation were rated much lower.
- The most common services brokers get from their MGA/AGA are managing compensation, tracking of policy issuance medical requirements, product training, compliance advice and administrative back office support
- The most common services brokers provide themselves are office space, succession planning and licensing support

We asked agencies to tell us the most important services they provide to brokers.

- Most agencies said the most important service they provide is administrative co-ordination between the broker and insurer (91%). Only a small number cited ensuring the application is complete as important.
- Policy tracking and product training were also common services provided to brokers. Least common were the provision of office space, branding, succession planning (this is consistent with broker responses)

#### Market conduct/supervision of broker by agency

We asked a number of questions related to the agency's 'supervision' or monitoring of the brokers they have contracts with.

Brokers said,

- Proof of their regulatory compliance is required by both their MGA/AGA and insurance company. The most common proof required by agencies relates to license renewal, E&O insurance and conflict of interest disclosure. Oversight of their AML and privacy obligations was also common, but to a lesser degree.
- They felt that the current level of monitoring by their MGA/AGA is sufficient (55% agreed with this statement).
- Compliance information is most commonly acquired from their professional association (like IFB); next most common is the MGA/AGA and less common is the life insurance company. Fewer said they look directly to their provincial regulator for this information.

Agencies said,

- They require brokers to provide proof of compliance most often for License renewal (96%), E&O (92%), CE (56%) and Disclosure (50%). The smaller numbers for CE and Conflict of interest disclosure was because some agencies said this was the insurer's responsibility.
- Over 80% of agency respondents said they were satisfied or very satisfied with their current level of monitoring of broker activities. A further 15% were neutral.
- The broker is responsible for suitability, needs assessment and documentation to support the suitability of his/her recommendation. Some agencies offer training on the importance of the broker's obligations related to suitability, needs assessment, conflict of interest disclosure and privacy. The insurer usually trains on anti-money laundering obligations.

- Most agencies get updated compliance advice from the insurance companies; followed by their professional association (like IFB), or in-house compliance officer.
- Over 80% of agencies currently have Corporate E&O coverage (some respondents operate in jurisdictions which do not require separate corporate coverage)
- 65% said no further regulation is required, 8% were not sure.
- 27% said more regulation is needed. Several said it was because the lack of regulatory harmonization leads to too many different rules.

#### Client contact

Responses from brokers and agencies were consistent when asked about client contact. Both agreed that the broker is primarily responsible for client contact and the agency has little direct contact.

- Most agencies which have client contact said it was to handle inquiries or provide written or electronic (on their website) information. Very few said they mediate disputes. If they receive complaints from clients, the majority said they would refer the client back to the broker.
- Most brokers said they conduct their business with clients directly and the MGA has very little client contact. Where they do, it tends to be related to a complaint.

#### **CONCLUSION**

As stated at the outset, it is our hope that the foregoing information will help regulators gain a better understanding of the marketplace. We believe there is much value in the current regulatory structure and trust regulators share this perspective.

This is not to say, of course, that if a gap in regulation truly exists that reforms should not be put into place to deal with those specific issues. For example, if there are MGAs who actively engage with clients and promote their products to the public, this may require some additional oversight. However, our survey shows that many agencies have little or no direct client contact and their business-to-business activities present no threat to consumer protection. In the event of an administrative oversight, most agencies have corporate E&O, which is the appropriate recourse for consumers. On balance, we hope that regulators will share our confidence that the current regime works well and protects the consumer.

The purchase of life/health insurance is different from many financial products in that it generally remains in place for many years. It is worthy of note that our members feel strongly that they have an important role as advocates for their clients. They have the knowledge and experience to go head to head with the insurance company when they feel their client needs assistance or has a complaint. Without their broker as advocate, clients would be left to try and negotiate their complaint on their own – sometimes long after the original purchase date.

Much has been made of the similarities or dissimilarities in compliance between the mutual fund industry and life insurance, particularly with regard to segregated funds. Insurance agencies do not serve the same business function as mutual fund dealers. Similarly, insurance companies are subject to a regulatory regime which imposes on them ongoing obligations with respect to the brokers they have contracts with and to the policyholders who invest in their products. There is no similar obligation on the part of a mutual fund manufacturer. We have before us a mutual fund industry that is collapsing under the weight of regulation and the cost (in time and money) of compliance. The trend of consolidation and convergence continues as smaller players in this market can no longer remain competitive.

In today's marketplace, independent brokers can place their business with a wide range of insurers. Ultimately, this choice benefits consumers who are more likely to obtain the best product to meet their needs. The broker's choice of MGA/AGA under the current system is invisible to the consumer, yet is still routed in his access to the insurer of his choice.

We welcome the opportunity to offer these comments to members of the CCIR and would be pleased to discuss any of our points in greater detail, as required.