Managing General Agents (MGAs) Guideline

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DRAFT FOR COMMENT

BC AUTHORIZED LIFE INSURERS



PURPOSE

This draft guideline outlines best practices that the Financial Institutions Commission (FICOM)¹ expects life insurers to adopt when using Managing General Agents (MGAs) to distribute individual life insurance products. These best practices incorporate the recommendations set out by the Canadian Council of Insurance Regulators (CCIR) in its November 2012 position paper (MGA Paper)².

INTRODUCTION

A regulated financial institution is responsible to have adequate controls and oversight of its business functions to ensure that undue risk or harm to the public does not occur. This includes prudent and effective controls over any business function outsourced to, or provided by, a third party.

Insurers enter into MGA arrangements to meet marketplace challenges such as economies of scale, cost control and heightened competition. Insurers should have the flexibility to configure their distribution operations in the most appropriate way to achieve their corporate objectives. However, insurers need to be aware that these arrangements can increase their dependence on the MGA, which may increase their risk profile if the arrangement is not properly managed or controlled. While insurers establish oversight and control processes for outsourced functions they consider to be material, research conducted by CCIR for the MGA Paper suggests insurers may not be implementing such processes for functions outsourced to MGAs. This guideline sets out best practices insurers should adopt to manage business done with an MGA.

The guideline sets out both *Principles* and *Standards*:

Principles

Principles communicate the spirit of FICOM's expectation without prescribing the form by which the principle is achieved. They form the foundation for effective management of MGAs expected by FICOM.

Standards

Standards set out specific policies and procedures that underpin Principles; in most cases standards are set at a level FICOM expects can be adopted and substantively implemented at every company.

¹ References to FICOM may include staff, the Superintendent and/or the Commission.

² The MGA Paper, and supporting background work, can be viewed on <u>CCIR's website</u>.

FICOM'S EXPECTATIONS REGARDING INSURER-MGA RELATIONS

Insurers are expected to have an appropriate strategy in place for any business conducted through an MGA. The strategy should incorporate the following best practices:

Selection of the MGA

Insurers must conduct appropriate due diligence on any MGA they intend to do business with.

Oversight and Controls of the MGA

Insurers must have effective systems and controls over the services provided by the MGA.

Selection, Screening and Monitoring of Agents

Insurers must have effective processes to ensure any insurance agent who distributes their products in British Columbia, including independent agents, has been screened for suitability and is subject to ongoing monitoring for suitability.

Reporting Unsuitable Agents

Insurers are expected to immediately report to the appropriate regulatory authority any agent who is believed to be unsuitable.

FICOM has developed six core principles to assist in implementing these best practices. How an insurer meets the six principles may vary, depending on the nature of the MGA arrangement, the relationship between the insurer and the MGA, and whether the MGA is being used to manage the insurer's relationship with insurance agents.

Besides these six principles, insurers also need to consider guidance issued by the Insurance Council of British Columbia (Council)³ in establishing their strategy.

³ Council's notice can be viewed on their website.

BEST PRACTICE: SELECTION OF AN MGA

PRINICPLE #1:

An insurer must have a clear strategy for selecting, appointing and managing an MGA as part of its overall distribution plan. This strategy should be applied consistently across all MGA arrangements and needs to be regularly reviewed and updated.

STANDARDS

- 1. An insurer's strategy⁴ should include:
 - an overview of the insurer's risk philosophy and any specific risk tolerances;
 - an outline of the objectives for the insurer's use of MGAs, the expected benefits, the functions to be delegated, and specific performance measures; and
 - information on the selection process of an MGA, compensation, limits on volume of business and type of products and geographical limitations.
- 2. Boards and senior management should consider the following risk factors when developing the insurer's strategy:
 - the impact of the MGA arrangement on the finances, reputation and operations of the insurer particularly if the MGA should fail to perform over a given period of time;
 - the ability of the insurer to maintain appropriate internal controls and meet regulatory requirements, particularly if the MGA were to experience problems;
 - the current and future cost of the MGA arrangement, taking into account the negotiating power of the MGA;
 - the degree of difficulty and time required to find an alternative MGA or to bring the business activity 'in-house'; and
 - whether the MGA has any relationships with other insurers that may impact or influence the provision of services.

DISCUSSION

Strategies will often be subjective and depend on the circumstances faced by individual insurers. However, the insurer's Board must satisfy itself that the strategy is clearly defined and the insurer has the controls and resources (both systems and individuals with suitable experience and skills) to manage the insurer's MGA strategy effectively.

⁴ This strategy can be part of an overall marketing or distribution plan.

BEST PRACTICE: SELECTION OF AN MGA

PRINICPLE #2:

An insurer carries out thorough due diligence of each MGA prior to entering into the arrangement to provide services.

STANDARDS

- 1. Due diligence should consider at least the following factors:
 - an assessment of the experience and technical competence of the MGA to implement and support the contracted services, this includes a review of the experience and technical competence of employees to be involved with the contracted services;
 - the financial strength and capacity of the MGA to perform the contracted services, including under various different business projections;
 - the MGAs business reputation, complaints history, regulatory compliance issues, and any past or outstanding litigation;
 - its internal controls, reporting and monitoring environment;
 - business continuity and contingency plans the MGA has in place in the event of disruptions or problems, including those for functions subcontracted out;
 - errors and omission, liability and other insurance coverage;
 - how the MGAs business objectives, human resource policies, service philosophies and business culture fit with those of the insurer; and
 - the MGA's ability to comply with all relevant regulatory, fiscal and taxation requirements.

DISCUSSION

All insurers should apply effective standards to prescreen any MGA to ensure that the MGA has the capability to provide the expected services and will have appropriate controls and processes in place over the functions it is to perform for the insurer. The insurer should be satisfied that the MGA will provide the delegated services appropriately and in compliance with regulatory requirements. As part of its screening the insurer should pay careful attention to the business reputation of the MGA and its senior management. If the MGA intends to subcontract any of the delegated functions, the insurer should extend its due diligence to the subcontractor.

BEST PRACTICE: OVERSIGHT AND CONTROLS

PRINCIPLE #3 (EFFECTIVE MGA AGREEMENT):

An insurer must have a written agreement in place with each MGA which clearly defines the conditions, scope and limits of contracted services. This agreement should be reviewed and, if necessary, updated at least annually.

STANDARDS

- 1. Insurers should include the following in the agreement⁵:
 - the nature and scope of the service(s) being provided, the scope of the relationship, and set out the territories or jurisdictions where the MGA will provide the service(s);
 - performance measures to determine whether the commitments contained in the agreement are being fulfilled;
 - the type, and frequency, of reports and information the insurer expects to receive from the MGA to allow the insurer to assess whether the performance measures are being met and any other information required for the insurer's monitoring program;
 - a protocol for resolving disputes;
 - a process for the MGA to report agent terminations (and the reason for the termination), or disciplinary actions it becomes aware of taken against an any agent;
 - a requirement that the MGA report to the insurer any complaint received about an agent, and a requirement that the MGA provide the complainant with information on the insurer's complaint resolution process;
 - a requirement for the MGA to have an appropriate business recovery/business continuity plan in place with regular stress testing undertaken to ensure it is functional;
 - inspection requirements and rights of the insurer to examine, review or audit the service provided or, alternatively to cause an independent person to evaluate, on its behalf, the service provided, including a review of the service provider's internal control environment as it relates to the service being provided;
 - confidentiality and security requirements for the MGA which should be commensurate with those of the insurer, including a notification process and standards for securing at any time the insurer's data, records, and items in the possession of the MGA or subcontractor, including under adverse conditions;
 - a process for determining fees and compensation;
 - a requirement for Errors and Omissions insurance to be in place at all times in the amount considered sufficient by the insurer, and a requirement that the MGA notify the insurer about any significant changes in its insurance coverage;

⁵ Some factors may not be applicable in all circumstances,

- a requirement for the MGA to notify the insurer of any civil judgments or disciplinary action taken against the MGA by professional organizations, licensing authorities or self-regulatory bodies; and
- a requirement for the insurer to pre-approve all training, market or promotional materials used by the MGA which refer to the insurer's products, trademarks and logos, regardless of media.

DISCUSSION

Insurers should review at least annually each MGA agreement to confirm it encompasses all necessary elements, meets the insurer's business objectives and mitigates associated risks. This review should take into consideration the insurer's assessment (see Principle #4) of the MGA's ability to continue to provide the contracted services.

MGA agreements should also be reviewed periodically by the insurer's internal audit department or another independent review function. This function could either be internal or external to the insurer, provided it has the appropriate knowledge and skills.

BEST PRACTICE: OVERSIGHT AND CONTROLS

PRINCIPLE #4 (OVERSIGHT):

An insurer proactively manages the MGA relationship, including compliance with the contract conditions, once its arrangement with an MGA is in place. Insurers are expected to address all issues relevant to managing the risks associated with the use of MGAs to the extent feasible and reasonable, given the circumstances and having regard to the interests of the policyholders.

STANDARDS

- 1. Insurers should incorporate and implement the following elements in its oversight and monitoring processes of the MGA relationship:
 - monitoring procedures⁶ to ensure that the service is being delivered in the manner expected and in accordance with the terms of the agreement;
 - monitoring procedures to ensure on-going adherence by MGAs to relevant legislative requirements in all jurisdictions where the MGA's services are being provided;
 - clearly defined procedures to identify irregularities with business conducted through the MGA (such as fraud and dishonesty), including notification to regulators;
 - a process to address non-renewal or cancellation of an agreement with an MGA in an appropriate manner; and
 - an internal process to test the effectiveness of the insurers management of MGA arrangements.
- 2. Insurers should use annual reviews to test the MGA's operations to ensure:
 - the MGA is following the insurer's code of conduct for conducting its business and meeting the requirements as set out in the agreement;
 - the MGA has effective management controls over the services provided including those subcontracted;
 - the adequacy and accuracy of management information reports provided by the MGA; and M<

The Board and senior management are responsible to develop and implement effective processes and controls to assess and mitigate risks to the company.

Effective governance and risk management of MGAs is essential to the safety and stability of the life insurance industry and needs to be included in a risk management plan for distribution.

Effective oversight of MGAs helps protect policyholders and allows regulators to reduce the amount of supervisory resources needed to ensure proper conduct within an insurer's distribution channel.

The Board retains overall accountability for how an insurer distributes its products and it should be aware of the company's strategy for using MGAs. In addition, Boards should receive periodic reports on whether this strategy continues to meet the company's business objectives.

⁶ The sophistication of the procedures should be commensurate with the size and complexity of the MGA arrangements and with the expectations of this guideline.

• the personnel used by the MGA to provide the contracted services are qualified and appropriately licensed.

DISCUSSION

Insurers need to continually monitor and assess the performance of each MGA used for adherence to the terms of the agreement and the MGAs ability to continue to provide the contracted services in a manner satisfactory to the insurer.

Monitoring may take the form of reports, regular, formal meetings with the MGA staff and/or periodic reviews of the specified performance measures. To monitor performance, insurers should specify within the agreement which information the MGA is required to provide, and the frequency of reporting.

Insurers should act promptly to correct any problem or potential issue identified with an MGA or subcontractor.

BEST PRACTICE: SELECTION, SCREENING AND MONITORING OF AGENTS

PRINICPLE #5:

An insurer must ensure that any agent distributing its products in British Columbia has been screened for suitability and is subject to ongoing monitoring for suitability.

STANDARDS

- 1. Insurers should consider the following questions when developing its initial, and ongoing, screening process of agents:
 - Is the agent/salesperson appropriately licensed?
 - Do they have appropriate product knowledge and expertise on the insurance product?
 - Do they act in good faith and in the best interests of the insured?
 - Do they adhere to regulatory requirements, the insurer's code of conduct and other industry standards?
 - Are there unresolved criminal charges or have they been convicted of a financial crime?
 - Have they been subject to regulatory discipline, or regulatory investigation?
 - Is there any evidence of financial stress, bankruptcy or undischarged bankruptcy?
 - Do they carry all required Errors and Omissions insurance?
- 2. Insurers should be mindful of the following behaviour as it is unacceptable market conduct:
 - selling without a licence or otherwise violating the terms/conditions of a licence;
 - breach of privacy or confidentiality laws or rules, or violation of holding out laws or rules;
 - failure to disclose a material conflict of interest;
 - tied selling or premium rebating, except to the extent permitted by law;
 - poor sales practices like indiscriminate replacements, twisting, churning or persistency issues;
 - poor disclosure or material non-disclosure;
 - misuse of, or material changes to, company-provided illustrations;
 - poor needs analysis or failure to assess product-client suitability;
 - material misrepresentation or omissions;
 - coercion or undue influence;

- inducements to insure, where prohibited by law;
- misleading statements to an insurer;
- commission-sharing with an unlicensed individual;
- unnecessary delay in delivering policies or failure to deliver policies; or
- trafficking in insurance policies, where prohibited by law.

DISCUSSION

Insurers are accountable for the products they offer and how those products are delivered. As such, insurers are expected to have adequate systems to ensure that agents acting on their behalf are suitable to carry out business as an insurance agent. This expectation applies regardless of whether the agent is a career agent or an independent contractor working through an MGA.

Insurers should apply effective standards to screen and monitor the suitability of an agent on an ongoing basis. The public is put at risk if agents are not thoroughly screened and monitored, and it creates legal and reputational risk for the insurer.

If an insurer delegates some or all of the screening and/or ongoing monitoring functions to an MGA, this should be built into the MGA agreement. It should include the insurer's expectations as to what factors the MGA should consider when screening and conducting ongoing monitoring. By incorporating those standards, the MGA will also be contractually required to follow those standards. All standards should be equally if not more stringent as those implemented by the insurer in its own screening practices.

Before delegating any of these functions, the insurer should confirm that the MGA is capable of carrying out the screening function and has in place processes to monitor agents on an ongoing basis. The insurer should also monitor the MGA's performance of the function. When an insurer delegates a compliance function, such as screening or ongoing monitoring of an agent, the insurer still remains accountable to FICOM for maintaining oversight of the agents with whom it does business.

If the insurer has not screened the agent or cannot verify the agent has been screened or has reasonable grounds to believe that an agent or MGA is unsuitable, the insurer should not accept business from that agent. Appropriate suitability screening and ongoing monitoring of agents promotes confidence in the industry, as well as protects the insurer and consumers.

BEST PRACTICE: REPORTING UNSUITABILITY OF AGENTS

PRINCIPLE #6:

All regulated parties are responsible to report misconduct; however both parties do not need to report the same incident. The obligation to report misconduct to the insurer should be set out in the MGA-insurer agreement and the obligation for the insurer to report to the regulator is to be respected at all times.

STANDARDS

- 1. Types of MGA conduct that should trigger reporting include⁷:
 - criminal acts such as fraud, forgery, money laundering, theft or misuse of client funds;
 - acting as an unlicensed agent;
 - failure to maintain Errors and Omission insurance, meet educational requirements or other licensing requirements;
 - unacceptable market conduct⁸;
 - privacy or confidentiality breaches or holding out breaches⁹;
 - failure to disclose conflicts of interest;
 - deliberate misrepresentation or incomplete disclosure regarding a product;
 - misleading consumers (either deliberate or accidental ¹⁰);
 - competency or trustworthiness concerns; and
 - providing incomplete comparisons and/or unsuitable product recommendations.

DISCUSSION

As with screening and monitoring, all insurers should have effective systems to identify and report unsuitable conduct.

If unsuitable conduct or any unlicensed insurance activity is identified, the insurer should report it to the appropriate regulator immediately. If an agent is engaging in unsuitable conduct or unlicensed activity this can place the public at risk and potentially create legal and reputational risk for the insurer.

⁷ This is not an exhaustive list. Any activity that may lead a member of the public to reasonably doubt that the agent is reliable, trustworthy or acting in their best interests should alert the insurer.

⁸ See Principle 5 for a list of unacceptable market conduct behaviour.

⁹ Intentionally misleading consumers about who they are dealing with or their ability to represent.

¹⁰This may include poor business knowledge of insurance products resulting in poor recommendations.

FICOM recognizes that there are divergent views regarding the responsibility of reporting misconduct to regulators. Some industry stakeholders believe that insurers should report misconduct after it has been investigated while others believe that both MGAs and insurers are responsible to report any misconduct.

However, FICOM expects insurers to report unsuitable behavior once the insurer becomes aware of it. Regulators are responsible for public protection and need the earliest opportunity to investigate any potential misconduct.



Financial Institutions Commission

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