GUIDELINE IMPACT ANALYSIS STATEMENT

GUIDELINE: MANAGING GENERAL AGENTS - LIFE DISTRIBUTION

DATE: JUNE 2013

DISTRIBUTION: ALL AUTHORIZED LIFE INSURERS

PURPOSE

To inform all life insurers authorized in British Columbia that the Financial Institutions Commission (FICOM) intends to adopt a guideline outlining best practices for insurers to manage and control business relationships with Managing General Agents (MGAs) involved in the distribution of individual life insurance products.

This document provides background information and analysis which supports FICOM's intention to adopt the guideline.

BACKGROUND

Insurers are expected 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.

Since the late 1990s, life insurers in Canada have increasingly used MGAs to assist in the distribution of individual life insurance products. Insurers enter into MGA arrangements to meet marketplace challenges such as economies of scale, cost control and heightened competition. However, these arrangements can increase an insurer's dependence on the MGA and may increase the insurer's risk profile if the arrangement is not properly managed. There can also be increased risk to the public if, as a result of the use of MGAs, independent life insurance agents are not properly screened or subject to ongoing monitoring for suitability.

Recently, in examining the role of MGAs in the individual life market, the Canadian Council of Insurance Regulators (CCIR) found that insurers may not have in place sufficient oversight or control strategies and processes to mitigate risks from using MGAs. CCIR set out a number of recommendations in its position paper *"Strengthening the Life MGA Distribution Channel"*[1] (MGA Paper) to improve the oversight and controls insurers have over MGAs. FICOM supports those recommendations and has drafted this guideline to set out expectations for insurers who use MGAs as part of their distribution channel for individual life insurance.

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ISSUES

The sale of individual life products by independent agents with the assistance of MGAs has become an increasingly important distribution channel for many life insurers. In its MGA Paper, CCIR identified the following potential issues from the use of MGAs in this distribution channel:

- Insurers may not have in place adequate strategies setting out why and how they intend to use an MGA;
- Insurers may not have in place any criteria or processes for the selection and pre-screening of an MGA before contracting with one;
- Insurer/MGA contracts may be too vague and generic so insurers and MGAs are not always certain of what is expected of each other or in respect of any function delegated;
- Insurers may not have sufficient processes or controls in place to monitor and assess the performance of the MGA on an ongoing basis;
- Insurers need to ensure that independent agents who sell their products are adequately screened for suitability, supervised and monitored for suitability on an ongoing basis; and
- Insurers need to ensure that unsuitable agents are reported.

If insurers do not have sufficient controls and oversight over the selection and use of MGAs, or to ensure that the independent agents placing business with it are adequately screened and supervised, the insurer may face significant risk; reputational risk, business quality risk, business volume risk, legal risk and regulatory risk.

FICOM believes that insurers who use MGAs need to have an effective strategy in place over their selection and use. That strategy should establish the insurer's objectives, risk appetite, performance measures and functions that can and cannot be outsourced. It should also establish screening processes and criteria, contractual content requirements, and reporting requirements. The board also needs to ensure that management has effective oversight controls and processes to ensure that the insurer is monitoring and assessing the MGA's compliance and performance on an ongoing basis.

Insurers also need to recognize their responsibility to ensure that any agent who sells their products has been screened for suitability prior to accepting any business from that agent and ensure that the agent is subject to ongoing monitoring for suitability. Insurers should establish standards for screening and monitoring of agents and ensure that they are being followed. 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. The agreement should incorporate the insurer's standards or factors for screening and monitoring and ensure the MGA applies those standards when performing those functions.

FICOM also expects insurers to immediately report any agent it believes may have or be unsuitable or that may or is engaging in an inappropriate manner to the appropriate regulatory authority. Insurers should have a clear understanding of what the industry and regulators consider to unsuitable conduct and implement rigorous processes to ensure that it can identify when an agent is unsuitable or engaging in misconduct. Insurers should ensure that any contracted MGA is also aware of the insurer's standards for conduct and include an obligation for the MGA to report to the insurer any suspicion of unsuitability in the MGA agreement.

By developing a guideline, FICOM can outline what it believes to be best practices for life insurers to adopt when managing the insurer-MGA relationship and thus reduce risk to the insurer and help prevent harm to the public.

OBJECTIVES

FICOM intends to establish best practices for insurers to adopt that will address the following objectives aimed at reducing risk to the insurer and preventing harm to the public:

- ensure that insurers have in place appropriate processes to select and contract with an MGA to provide services;
- ensure insurers are aware of their obligations to have in place adequate controls over any MGA that they outsource a business function to and have implemented effective oversight and controls over the MGA to ensure it is meeting the insurers expectations;
- clearly establish expectations that insurers are responsible for ensuring that any agent that sells its products has been screened for suitability and is subject to ongoing monitoring for suitability; and
- clearly establish expectations that insurers are responsible for reporting any agent misconduct or unsuitable agents to the appropriate regulatory authority.

OPTIONS AND ASSESSMENT

Option 1: Adopt CCIR's Recommendations from its Position Paper

The CCIR paper sets out a number of recommendations that FICOM supports. However, FICOM believes that the paper does not provide sufficient guidance on what should be considered best practices, nor offers guidance for an insurer's strategy, internal processes or controls.

Option 2: Adopt FICOM Specific Guidance

By adopting its own guidance, FICOM can establish best practices that it believes appropriate to address the risks it has identified; the potential risk to insurers for not having in place adequate controls over this part of its distribution channel, the risk to consumers from having inadequate controls and oversight of MGAs, and the agents who place business through them.

Recognizing that industry wishes to see harmonization and consistency across jurisdictions, in drafting its own guideline, FICOM will take guidance from the CCIR recommendations and existing industry best practices.

Option 3: Do Not Adopt Guidelines

This option would retain the status quo for life insurers and MGAs. FICOM would not adopt any guidelines or set out any expectations and would rely on existing industry practices.

FICOM recognizes that adopting these guidelines will impact insurers and may lead to increased costs. However, FICOM also believes that insurers are responsible for ensuring that they understand and have taken appropriate steps to mitigate risks from this distribution channel and are screening and monitoring agents for suitability and are reporting unsuitable agents. FICOM believes that failure of insurers to control risks from this channel may lead to increased risk for the insurer and cause harm to the public.

RECOMMENDATION

FICOM recommends that it pursue Option 2: Adopt FICOM Specific Guidance.

CONSULTATION

FICOM is seeking comments from authorized life insurers, MGAs and other industry stakeholders on the draft guidance by July 26, 2013. FICOM will review all comments to determine if any additional amendments need to be made before adoption.

IMPLEMENTATION

If adopted, the guideline will be implemented and become effective immediately. FICOM will issue communication to the system regarding the implementation process once the guideline is released in final form.