

Position Paper

Strengthening the Life MGA Distribution Channel

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ABOUT CCIR 3
AGENCIES REGULATION COMMITTEE (ARC) 3
ARC WORK TO DATE 4
PURPOSE OF THIS PAPER 4
RESULTS OF ISSUES PAPER CONSULTATION 5
1. Functions Outsourced to MGAs 5
2. Supervision of Representatives 6
3. Managing Conflict of Interest Principles 9
4. Role of MGAs in Sales Transactions and Handling of Consumer Complaints 10
5. Compliance with Privacy Legislation 11
6. Who is watching over MGAs? 11
ARC RECOMMENDATIONS 13
Insurer Relationship with MGAs 13
Agent Supervision 13
Product Suitability 14
Information needs of regulators 14
APPENDIX 1 BEST PRACTICES FOR INSURER-MGA RELATIONSHIPS 15
Executive Summary 15
Introduction 15
Principle One – A clear Strategy 17
Principle Two – Thorough Due Diligence 18
Principle Three - Well-defined roles and responsibilities 19
Principle Four - Active Oversight 22

ABOUT CCIR

The Canadian Council of Insurance Regulators (CCIR) is a forum for Canadian insurance regulators to collaborate to improve insurance regulation to serve the public interest.

CCIR adopted our *Approach to Risk-based Market Conduct Regulation* over three years ago. Since then we have been implementing a risk-based approach in everything we do. We don't just react - we identify and assess risks first. We focus on the outcomes needed and how to accomplish them, not on rules and forms. We recognize that the best control is self-control, so we work with our industry stakeholders to develop industry standards so that all market participants know what is expected of them.

With a risk-based approach, regulators try first to understand what is happening in the marketplace, give industry the opportunity to respond, assess the quality of the industry response, and then determine if there are risks or gaps that may require the engagement of government policy staff to change the laws. In other words, policy-makers will intervene where problems remain unaddressed by the industry. This can also be described as a progressive approach to market conduct regulation.

If gaps or risks are identified, it is up to policy-makers in each jurisdiction to determine- based on their specific legislation and public policy objectives- what particular measures, if any, will be introduced, and in what manner, so that the regulatory goals of fair treatment of consumers and compliance with the laws can be met.

AGENCIES REGULATION COMMITTEE (ARC)

Over the past two decades, the distribution of individual insurance products[1] 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.

CCIR's strategic priorities include identifying common emerging issues (fact gathering), and engaging stakeholders and policy makers so that the right information is in the hands of those in charge of making policy decisions in a timely manner. Knowledge of what is going on in the marketplace increases the possibility that solutions can be found before potential risks become major problems.

CCIR, 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).

[1] This paper deals with non-group products manufactured by life insurance entities including life, annuity and accident and sickness products.

ARC WORK TO DATE

To understand how supervision and accountability may have changed in light of the increasingly important role of MGAs in the distribution of individual life insurance products, ARC began by gathering the facts around MGA arrangements.

In February 2011, ARC released an issues paper, entitled *Managing General Agencies Life Insurance Distribution Model,* for public consultation. The goal of the issues paper was to gain a better understanding of the marketplace, and to determine if changes in the life insurance industry resulting from the growth of the MGA distribution channel were creating risks to consumers, or making it difficult to comply with existing laws.

In the Issues paper, ARC shared with stakeholders its findings and potential concerns, asking stakeholders to clarify or confirm the facts. ARC wanted to clarify the role of MGAs in the distribution of individual life insurance products and to discuss a number of potential issues that had been raised by the public and media.

ARC asked stakeholders to consider 26 questions, which covered the following topics:

1. Functions Outsourced to MGAs
2. Supervision of Representatives
3. Managing Conflict of Interest Principles
4. Role of MGAs in Sales Transactions and Handling of Consumer Complaints
5. Compliance with Privacy Legislation
6. Who is watching over MGAs?

ARC met with a variety of stakeholders during the consultation period and ultimately received 23 submissions from stakeholders, the full-text of which has been posted on CCIR's website. We wish to thank all of those who participated in the consultation: your input has been invaluable in clarifying the issues.

PURPOSE OF THIS PAPER

ARC's objective with this position paper is to communicate back to stakeholders what we have learned from the consultation and to set out ARC's recommendations to CCIR members regarding the issues. These recommendations are intended to enhance and harmonize best practices in the MGA distribution channel.

This position paper was first released for comment in May of 2012. ARC was pleased to note the general agreement amongst respondents to the four recommendations and the Best Practices for Insurer-MGA Relationships principles attached in Appendix 1 of this paper. While some submissions noted additional points for ARC to consider in its ongoing work, given industry's positive response to the Position Paper, ARC decided to present the position paper to CCIR for adoption without amendment.

RESULTS OF ISSUES PAPER CONSULTATION

1. Functions Outsourced to MGAs

The issues paper sought clarity on a number of issues with respect to outsourcing, such as:

- Are there functions that should not be outsourced, for example product development or claims handling?
- How do insurers determine what functions they outsource and ensure that the MGA has the resources, expertise and capability to perform the functions?
- How do insurers monitor and oversee compliance of functions outsourced?

As long as there are adequate safeguards in place, it is not usually the role of insurance regulators to intervene in business decisions and restrict what can be outsourced to service providers. In the controls around the contracts between insurers and MGAs, the consultation found that there were some deficiencies that should be corrected.

ARC was pleased to note that there was consensus in the submissions from all industry segments that ultimate responsibility for tasks outsourced to MGAs rests with the insurer. There was also consensus that certain functions, including product development (although MGAs may collaborate with the insurer), claims handling, and underwriting are not currently, and should not in the future be, outsourced to MGAs. The general view is that these core insurer functions should never be delegated to MGAs as this could result in conflicts of interest and unequal treatment of customers.

However, as insurers do not view outsourcing to MGAs to meet materiality thresholds and, therefore, that the more stringent requirements set out in OSFI's outsourcing Guideline B-10 do not apply to them for this outsourcing, insurer practices and controls around the functions that they do outsource to MGAs vary widely.

On the question of how insurers determine whether to enter into an outsourcing arrangement, there were differing views. Some stakeholders suggest that there is very little screening before entering into an MGA agreement, while insurers submitted that they do screen their MGAs.

It was also noted that there is no standardization in the outsourcing agreements between insurers and MGAs. Contracts vary considerably, and some may be very generic to the point that MGAs are uncertain of their obligations.

There were also divergent views on the question of how insurers monitor and oversee MGAs to assure themselves that outsourced functions are being well performed and are in compliance with regulations and industry guidelines and best practices. However, all respondents expressed strong support for the merits of standardized compliance monitoring.

In assessing the overall feedback received from stakeholders, ARC believes that there may be deficiencies in insurers' screening of MGAs prior to entering into an outsourcing arrangement, and in insurers' ongoing monitoring and assessment of MGAs with whom they have contracts. It was confirmed

that many existing insurer-MGA contracts are too vague and generic, leaving MGAs uncertain of what the insurer's expectations are in respect of the functions delegated.

ARC does note some very positive movement in the industry in these areas. There was strong support for ongoing industry initiatives, such as the work CAILBA has undertaken in developing a robust compliance "toolbox" for its members to assist them in developing stronger internal controls and compliance functions, and the audit survey CLHIA has developed to be used by its member insurers to conduct compliance monitoring of MGAs.

Issues Identified

- There may be deficiencies in insurers' screening of MGAs prior to entering into an outsourcing arrangement.
- There may be deficiencies in insurers' ongoing monitoring and assessment of MGAs with whom they have contracts.
- Some existing insurer-MGA contracts may be too vague and generic so MGAs are not always certain of what are the insurer's expectations in respect of any function delegated.

2. Supervision of Representatives

More generally called "Agent supervision," this refers to the role that insurers have to screen and monitor agents selling their products to ensure that they are licensed, carry Errors & Omission ("E&O") insurance, fulfilled proficiency (LLQP) and any continuing education requirements, and are not engaging in inappropriate behavior[2]. An important component of "agent supervision" relates to reporting to regulators misconduct findings so that the regulator can take action.

Taking into consideration changes that have occurred in the life insurance industry with the growth of the MGA distribution channel, ARC sought clarity on whether there is adequate oversight of insurance agents, and appropriate reporting of misconduct to regulators.

It is important to understand that, although MGAs have become a very important component of the life insurance distribution system, this does not change the roles and responsibilities of the parties, as currently defined under the laws that apply to insurance. For example, an insurer remains responsible to the policyholder for its products by virtue of a binding contract. It does not matter if the policy was sold by a career or by an independent agent, and whether or not the independent agent was recruited by an MGA. Similarly, under the law of agency, if an insurance agent acting on behalf of an insurer is

[2] The suitability for clients of products recommended by intermediaries is a separate issue dealt with in part 3 of this paper under "product suitability."

improperly monitored, this may trigger liability for the insurer regardless of the fact that the agent may act on behalf of more than one insurer, through one or various MGAs.

Although statutory insurance law varies across Canada, insurers have specific compliance obligations under these statutes. For example, there is generally an obligation for insurers to establish and maintain a system that is reasonably designed to ensure that each agent complies with the laws. Thus, when an insurer delegates to an MGA a compliance function such as the screening of agents, it remains accountable to regulators for maintaining oversight of the agents with whom it does business. Regulators are responsible for making sure that insurers are effectively discharging this responsibility.

Regulators and self-regulatory bodies with licensing responsibilities require agents to meet certain criteria before they are issued a licence, including proficiency requirements. These regulators have a duty to ensure that agents licensed in their jurisdiction are subject to ongoing supervisory review.[3] This can be done directly or indirectly (through supervision of the insurer), and both approaches are recognized by the International Association of Insurance Supervisors (IAIS).

ARC believes that the application by insurers of effective and uniform standards to screen, monitor and report the conduct of agents is very important.

In assessing the feedback received from stakeholders, ARC believes that there is recognition that there is in some jurisdictions a legal obligation on insurers to establish and maintain a system reasonably designed to ensure that agents acting on their behalf are suitable to carry on business as an agent, and comply with the duties agents have under law. This applies regardless of the agent being a career agent, or an independent contractor recruited by an MGA. Consequently, the insurer's compliance system must be tailored to include monitoring agents of all types and at all levels. However, not all jurisdictions provide for this legal obligation, which is where CLHIA Guideline G8 *Screening Agents for Suitability and Reporting Unsuitable Agents* comes into play.

In looking at the role of the MGA in agent supervision, it is also important to understand that the insurance regulatory model differs from the securities dealer's model in that the securities model is a one-on-one model where the registered sales representative of a dealer cannot act as an independent contractor and must always act under the sponsorship of that one dealer, who is legally responsible for the acts of its sales representatives. However, insurance agents are not necessarily bound to the direct supervision of one insurer, but can have contracts with more than one insurer, through one or more MGAs. This gives life agents more opportunities to offer a variety of products from various insurers to their clients, and to look for products that best fit their target markets.

The expectation, however, is that the level of supervision, accountability and training by insurers of its agents should be the same whether the life agent is a career agent or an independent agent contracted directly, or through an MGA.

It was recognized by stakeholders that the oversight of individual agents is currently shared, leaving no single entity – insurer or MGA - with a complete view of the totality of business dealings of an agent.

[3] This includes MGAs, who are currently licensed as insurance agents. See Part 6 – Who is watching over MGAs.

However, the prevailing view is that sharing of oversight does not diminish or otherwise alter the ultimate responsibility that an insurer has for the agents who represent it by selling its products. This responsibility is established statutorily in some jurisdictions, and described in detail in CLHIA Guideline G-8. Most stakeholders agreed that it is not in the consumer's best interest to move to a one-to-one supervision model. The consensus is that this would not add significantly to the protection provided consumers under the current model but would limit consumer choice by limiting access to the products of a variety of insurers.

According to some respondents, MGAs are often delegated responsibility to screen agents before accepting them on behalf of an insurer, and insurers expect in doing so that the MGA applies the same standards that they would apply, those set out in CLHIA Guideline G-8. This seems to be occurring to some degree in the industry.

Most stakeholders believe that the growth of the MGA channel does not appear to compromise the detection of unsuitable agent activity. There is no evidence that fraud, or other forms of illegal actions are any more prevalent in the MGA channel. Some believe that shared oversight may increase the likelihood that misconduct is detected, as there are significant numbers of checks and balances in existence at various levels.

There were divergent views on who should report misconduct to regulators with the CLHIA and most of the insurers favouring the view that insurers should be the ones responsible to report, after the insurer has investigated the matter, and those from the MGA/agent side suggesting that MGAs and insurers should both report any misconduct to regulators.

Although many favour MGAs reporting misconduct to both the insurer and the regulator, ARC believes that if there is an obligation to report misconduct to the insurer under the MGA-insurer agreement, and an obligation for the insurer to report to the regulator, there is no need to have both parties report to the regulator the same unsuitable behavior.

Stakeholder submissions also showed strong support for a centralized cross-Canada database documenting misconduct. This would assist both insurers and MGAs as they consider the suitability of new applicants for contracts as well as assisting consumers to make informed decisions about their advisors. CCIR has formed its Disciplinary Information Committee to look into the feasibility of such a database.

Issues Identified

- Although insurers have statutory and other legal obligations (contract law, agency law etc.) to supervise their agents, and regulators impose licensing requirements on agents, there seems to be a lack of understanding by the public of the safeguards in the system which has led to expressions of concern as to whether agents are receiving adequate and effective supervision.
- When elements of agent supervision are outsourced to MGAs, the requirement to abide by CLHIA Guideline G-8 should be clearly set out in the MGA contract.

3. Managing Conflict of Interest Principles

The ARC sought clarity on the application of CCIR Principles for Managing Conflicts of Interest in light of the prevalence of MGAs as intermediaries in the distribution chain. The three principles are:

- Client's interests come first: Agents must put the interests of policyholders and purchasers ahead of their own;
- Make clear any conflicts or potential conflicts of interest: Consumers must receive disclosure of any actual or potential conflict of interest that is associated with a transaction or recommendation; and
- Ensure products are the right fit: Products recommended must meet the needs of the consumer.

The general view is that these principles form part of industry codes of conducts and are the responsibility of the insurance agent. They require the representative to place the client's interest ahead of its own, report to the consumer any conflict or potential conflict of interest and ensure that the recommended product is suitable. The representative must comply with the three principles irrespective of acting as a career agent or through the MGA channel.

Generally, respondents did not think that MGA's involvement is creating additional conflicts of interest. Very few feel that it is possible for an MGA to influence the choices of an agent regarding the insurers that it recommends to a client. If any of the compensation mechanisms from MGA to agent create a conflict of interest, then the agent must disclose this to the consumer. The CLHIA Advisor Disclosure Reference Document suggests for the agent to disclose the name of the MGA with which he or she is associated, and ARC supports this direction.

It was recognized by stakeholders that commissions paid to MGAs by the insurer are not currently disclosed to consumers. However, this consultation process did not result in evidence that such disclosure would add to consumer protection.

As a result of this review, the ARC is of the view that while the CCIR Principles for Managing Conflicts of Interest appear to be strongly supported by respondents, there seems to be a lack of clarity in the

marketplace about the specific obligations of an agent when providing advice on the suitability of a product. Many industry association codes, insurance council by-laws and codes of ethics require that agents obtain information about the client's needs and recommend appropriate insurance coverage. There is also case law on the standard expected in terms of assessing the client's needs and requirements.

Although outside the scope of this paper, ARC notes that recommending a suitable product is an integral part of the agent's advice to their clients. The cases of unsuitable advice resulting in loss to consumers are newsworthy both because of their potentially devastating impact on the consumer, (as evidenced by the press coverage that preceded the release of the CCIR issues paper) and their rarity. Thus, ARC believes that it is appropriate for regulators to confirm in what manner, and how effectively, agents are discharging this obligation.

Issues Identified

- Although the CCIR Principles for Managing Conflicts of Interest form part of industry codes of conducts and are the responsibility of the insurance agent whether or not an MGA is involved, consumers seem to want additional reassurance that they are receiving competent product recommendations and advice that is free from conflict of interest.

4. Role of MGAs in Sales Transactions and Handling of Consumer Complaints

There has been some concern expressed that because many sales representatives are no longer directly an agent of the insurer, that the consumer oriented complaints handling procedures and ombudsman processes are not available for complaints against these agents. They are only available if the insurer is willing to accept responsibility for the actions of that agent in that particular transaction.

ARC sought clarity on what role MGA's have in handling consumer complaints about a representative; who should be accountable for errors in consumer transactions processed through MGA's; whether there is any obligation in the agreement between the MGA and the representative for the representative to report to the MGA any complaints received; and whether complaints against representatives or MGAs should have access to the OmbudService for Life and Health Insurance ("OLHI").

There was consensus that the involvement of MGA's does not in itself create any additional issues in this area – the issues arise because of the independence of agents. Most agree that the presence or absence of an MGA has no bearing on a consumer's ability to report transactional errors. If transactional mistakes are made, consumers would contact the representative with whom they have a relationship first, then the insurer.

Regarding reporting complaints, most MGA-representative agreements seem to include the obligation for the representative to report complaints received to their MGAs.

There was no agreement that the OLHI system should be expanded to cover complaints against representatives and MGAs. The general view is that complaints against representatives should be taken to the regulator as they have jurisdiction in these matters. CCIR will follow-up with the Dispute Resolution Committee of the Joint Forum of Financial Market Regulators, who first raised this issue, as to the results of this consultation.

5. Compliance with Privacy Legislation

Client information collected by the sales representative flows through the MGA on its way to the insurer. Insurers may also be disclosing personal information of customers to MGAs to process on their behalf. It was unclear to ARC whether MGAs are directly retaining client records containing personal information, or retaining client records on behalf of the insurer or the agent who obtained the client's consent, however, no action is required as privacy laws address this matter and any breaches are subject to the jurisdiction of privacy commissioners.

6. Who is watching over MGAs?

ARC's first concern -that MGAs may not be adequately supervised by insurers – was addressed above, under subsection 1, Functions Outsourced to MGAs. This section will deal with the other aspect of MGAs oversight: regulators' supervision of MGAs.

It was confirmed by stakeholders that virtually all MGAs are currently licensed as life insurance agents because their principals write business themselves or because the MGA entity receives commission payments from insurers, thus making provincial licensing legislation applicable. Because this legislation was put in place before MGAs became a central part of the life distribution model, there is no specific licensing category for MGAs in any Canadian jurisdiction.

Some respondents were of the view that the Errors & Omissions insurance currently provincially mandated for agents may not be adequate for MGAs, but ARC found no rationale supporting this. Most stakeholders agree that very rarely there are MGA errors that may give rise to complaints.

The fact that there are a number of different MGA business models and roles played by MGAs was seen as positive. The industry in general does not favor a one-size-fits-all approach to deal with MGAs, but prefer the existing flexibility of various MGA business model to meet a diversified demand in the marketplace. ARC understands the benefits of a flexible approach regarding a variety of MGA business models, and believes this is feasible as long as regulators are informed.

Some respondents suggested that regulators should develop a specific licensing regime to encompass the role that MGAs currently have in the marketplace. Licensing is not an end in itself, but a means to an end. Accordingly for a licensing regime to contribute value there need to be specific consumer protection outcomes that are required. The analysis in the paper indicates that there are no specific

consumer protection goals that would be advanced though an MGA specific licensing regime. However, there is a need for regulators to develop a method to be able to identify the business model of those licensed as a life agent within their licensing regimes, including MGAs.

ARC believes that to be able to monitor risks in the market place, regulators must be informed about the business practices of their licensees. Examples of the market intelligence regulators must possess to effectively supervise the market include knowing whether the licensee is:

- licensed as an individual, a partnership or a corporation,
- operating as a career agent or an independent agent,
- associated to one or more MGAs and who those MGAs are,
- an MGA itself, and if so, who are the insurers with whom it has agreements in place, and who are the agents,
- an AGA, and if so, who are the MGAs with whom it has agreements in place.

Issues Identified

- Regulators need to be better informed– not only about insurers and the MGAs with whom they contract- but also about who are the insurance agents licensed in a particular jurisdiction, what is their business model, and how many of these licensed agents are performing functions that fit the definition of an MGA.

ARC RECOMMENDATIONS

The ARC acknowledges that jurisdictional differences may exist. Provinces may implement the recommendations below in conjunction with other measures that reflect any local or regional issues.

Insurer Relationship with MGAs

Recommendation 1: Insurers must have in place effective systems and controls whenever they use the services of an MGA

> **Commentary:** *The objective of this recommendation is to promote harmonization of best practices in the governance and management of MGA agreements by insurers. The foundation of this recommendation is that insurers are accountable to regulators for their relationships with MGAs. Examples of expected conduct or practices by insurers are contained in a "Best Practices for Insurer-MGA Relationships" document attached to this paper as Appendix 1, dealing among other things with due diligence before selecting an MGA, MGA contracts that clearly define roles and responsibilities, and ongoing compliance monitoring of tasks delegated.*
>
> *CCIR members will focus on the uptake of the best practices across the insurance industry. ARC is pleased to note the voluntary initiatives that the industry is already taking in this direction with the development by the CLHIA of its standardized MGA Compliance Review Survey and by CAILBA of its Compliance Toolbox. Each jurisdiction will consider the steps that industry members take and will evaluate the circumstances in its own jurisdictions to determine what, if any, changes are necessary to implement the best practices. These changes may include industry initiatives, regulation or a combination of both approaches.*

Agent Supervision

Recommendation 2: Insurers should incorporate the principles in CLHIA Guideline G8 - *Screening Agents for Suitability and Reporting Unsuitable Agents* into all of their business across Canada, including any contracts involving the outsourcing of these functions to an MGA.

> **Commentary:** *This recommendation flows from the fundamental principle that the insurer has a "duty of care" obligation to ensure that agents selling its products are suitable, and to report misconduct to regulators. This "duty of care" obligation is already recognized by law in some, but not all, jurisdictions. Duty of care obligations are also contained in CLHIA Guideline G8. By incorporating the G8 principles in MGA contracts, MGAs will also be contractually required to follow these standards. Following a period of transition to allow all industry participants to be in compliance, ARC recommends regulators conduct on-site examinations to make sure companies are adhering to Guideline G8.*

Product Suitability

Recommendation 3: Regular market conduct reviews should be undertaken by regulators to determine if insurers and their agents are providing consumers with adequate information to make informed decisions, and suitable product recommendations.

> ***Commentary:*** *While not directly linked to the MGA distribution channel, product suitability is - as confirmed by stakeholder responses during this review- nonetheless a very important issue that requires our attention.*
> *Both insurance agents and insurers have an important role to ensure consumers are empowered to make informed decisions and are presented with products that are suitable to their needs. Regulators have a role to verify that these two outcomes are achieved. An initiative is already underway by the Joint Forum, which phase one involves reviewing the processes in place at insurance companies when designing and developing new products and their marketing materials. Some provincial regulators (e.g. Ontario) are undertaking reviews of product suitability as part of their strategic priorities for 2012. The objective is to understand and assess the processes agents use in making recommendations to consumers, and making sure these are effective taking into consideration the increasingly complex products in today's insurance marketplace. If regulators' monitoring of the marketplace identify problems in the future that require additional action, further steps can be taken.*

Information needs of regulators

Recommendation 4: Regulators will develop options and an action plan to make sure that adequate information on life agents and MGAs is obtained in a timely manner.

> **Commentary**: *Regulators must have a clear understanding of who are those individuals or companies currently licensed as insurance agents in their jurisdiction; what is their business model and role in the distribution of life insurance products (MGA, AGA, career agent, independent agent with or without contractual relationships with MGAs). ARC will work with CISRO in developing options to make sure regulators are gathering the market intelligence required to assess risks in the marketplace.*

APPENDIX 1 BEST PRACTICES FOR INSURER-MGA RELATIONSHIPS

Executive Summary

Life insurers should have in place effective systems and controls wherever they use a MGA to manage their relationships with agents or salespersons.

Effective systems and controls would incorporate four core principles:

- Principle One – A Clear Strategy
  An insurer has a clear strategy for selecting, appointing and managing MGA arrangements as part of its overall distribution plan.
- Principle Two – Thorough Due Diligence
  An insurer carries out thorough due diligence of each MGA prior entering into the arrangement to provide services.
- Principle Three – Well Defined Roles and Responsibilities
  An insurer has a written agreement in place with each MGA which clearly defines the conditions, scope and limits of contracted services
- Principle Four – Active Oversight
  An insurer proactively manages MGA contracts once in place to ensure compliance with contract conditions.

How the life insurer meets these principles may vary, depending on the nature of the MGA arrangement being contemplated and the relationship between the insurer and the MGA.

Introduction

The best practices presented here operate on the premise that insurers remain ultimately accountable for all services provided on their behalf by MGAs.

This outline of best practices provides information to boards of directors and senior management of life insurance companies regarding their governance and risk management oversight of the use of MGAs.

Life insurers enter into MGA arrangements to meet marketplace challenges such as economies of scale, cost control and heighten competition. Insurers should have the flexibility to configure their distribution operations in the way most suited to achieve their corporate objectives. However, these arrangements can increase an insurer's dependence on the MGA which may increase its risk profile if the arrangement is not properly managed or controlled.

Effective governance and risk management of MGAs is an essential element in the safe and sound functioning of life insurance companies. . Strong board and senior management oversight of MGAs helps protect policyholders and allows regulators to rely on the insurers' internal processes, thereby reducing the amount of supervisory resources needed to ensure proper conduct within an insurer's distribution channel.

The special nature of life insurance companies set them apart from other business firms. The loss of confidence in the life insurance sector can have a significant impact on the public who have place a substantial amount of their life savings with life insurers and who may be relying on those life insurers for day-to-day protection from unexpected risks.

Life insurers accept premiums from policyholders and often deal in long-term financial commitments, which are predicted on a high degree of public confidence in understanding these commitments and the long-term stability and soundness of the insurer making these commitments.

Many life insurers have complex organizational structures with a large number of different entities used to deliver their financial products. For these organizations, the relationship between the various entities in the distribution channels merits special consideration by regulators.

Principle One – A clear Strategy

A life insurer to have a written strategy, approved by the board, for the use of MGAs, including services to be provided and any delegated authorities.

The strategy may include:

- An overview of what the insurer's risk philosophy is on MGA arrangements and any specific risk tolerances;
- An outline of the objectives for the insurer's use of MGAs within the distribution channel plus a description of the benefits and the extent to which any insurer functions will be delegated and expected performance indicators of success.
- Information on resourcing, compensation, how suitable MGAs will be identified, territorial considerations, limits on volume of business and type of products and geographical limitations.

  This strategy will often be subjective and depends on the circumstances faced by individual insurers. However, the board must satisfy themselves that management has the controls and resources (both systems and individuals with suitable experience and skills) to manage the insurer's MGA strategy effectively.

  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, or a significant business line, 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
- The potential that multiple MGA arrangements with other insurers, provided by the same MGA, may impact or influence the provision of the insurer's services.

This strategy should be applied consistently to all MGA arrangements and require these arrangements to be in writing and regularly reviewed and updated. This strategy can be part of an overall marketing or distribution plan.

Principle Two – Thorough Due Diligence

Insurers should have thorough due diligence procedures in place to fully assess the risk associated with the MGA arrangements and address all relevant aspects of the MGA, including qualitative (i.e. operational) and quantitative (i.e. financial) factors before entering into the MGA arrangement.

The due diligence of the MGA may include examining the MGA in light of these factors:

- 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 involved with these contracted services;
- Financial strength and capacity of the MGA to perform the contracted services, including under various different business projections;
- Business reputation, complaints, compliance and pending litigation;
- Internal controls, reporting and monitoring environment;
- MGA's business and contingency measures for ensuring the continuation of the contracted activities in the event of problems and events that may affect the MGA's operation such as a systems breakdown, natural disaster, an inability of a significant subcontractor to provide services relevant to the outsourced activity, and situations where extraordinary demands are placed on a MGA;
- Reliance on and success in dealing with agents and salespersons;
- Insurance coverage;
- Business objectives, human resource policies, service philosophies, business culture, and how they fit with those of the insurer; and
- Ability to comply with all relevant insurance, fiscal and taxation laws and requirements in the jurisdiction in which it is domiciled, trades or provides services under the binding authority.

Principle Three - Well-defined roles and responsibilities

MGA arrangements should be documented by a written agreement that addresses all elements of the arrangement and has been reviewed by the insurer's legal counsel.

Life insurance companies 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.

The items identified below should be included in the agreement; however, some may not be applicable in all circumstances:

- *Nature and Scope of the Service Being Provided*
  The agreement is expected to specify the scope of the relationship. The agreement is expected to detail the territories or jurisdictions the MGA will provide the service.
- *Performance Measures*
  Performance measures should be established that allow each party to determine whether the commitments contained in the agreement are being fulfilled.
- *Reporting Requirements*
  The agreement is expected to specify the type and frequency of information the insurer receives from the MGA. This would include reports that allow the insurer to assess whether the performance measures are being met and any other information required for the insurer's monitoring program.
- *Resolution of Differences*
  The agreement should incorporate a protocol for resolving disputes as well as the jurisdiction and rules under which the dispute will be settled.
- *Notification of Other Agent or Salesperson Termination*
  In the event that the MGA's relationship between itself and other agents and salespersons is terminated, the agreement should include the requirement for immediate notice to the insurer for the termination and reasons for the termination should be also be provided. In addition, the MGA should be required to notify the Insurer of any known disciplinary action taken against another agent or salesperson who is involved in the sale of the insurer's products by professional organizations, licensing authorities or self-regulatory bodies.
- *Complaints*
  In the event of the MGA receiving a complaint which is in any way connected to the services provided to the insurer, the agreement should require the MGA to immediately notify the insurer and provide information on the complaint. In addition, the agreement should require the MGA to inform the complainant of the insurer's complaint resolution process and how to person.

- *Contingency Planning*
  The agreement should outline the MGA's responsibility for ensuring the continuation of its services in the event of problems and events that may affect its operation, including systems breakdown and natural disaster, and other reasonably foreseeable events. The insurer should require the MGA to regularly test of its business recovery plan and be notified of the results and if the MGA encounters other circumstances that might have a serious impact on the services provided to the insurer.

- *Inspection Rights*
  The agreement is expected to clearly stipulate the 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. This includes a review of the service provider's internal control environment as it relates to the service being provided.

- *Confidentiality and Security*
  At a minimum, the agreement is expected to set out the insurer's requirements for confidentiality and security. Ideally, the security and confidentiality policies adopted by the MGA would be commensurate with those of the insurer and should meet a reasonable standard in the circumstances. The agreement should establish notification requirements if there is a breach of security. The MGA is expected to be able to logically isolate the insurer's data, records, and items in process from those of other insurers at all times, including under adverse conditions.

- *Compensation*
  The agreement should fully describe the basis for calculating fees and compensation relating to the service being provided.

- *Insurance*

  The MGA should be required to have appropriate errors and omissions insurance, in the amount considered sufficient by the insurer, and notify the insurer about significant changes in insurance coverage and disclose general terms and conditions of the insurance coverage.

- *Regulatory Requirements*
  The agreement should require the MGA at all times maintain all necessary licenses to lawfully carry out insurance business in those jurisdiction where the MGA is permitted to provide its services to the insurer. The MGA should be required to notify the insurer of any civil judgments or disciplinary action taken against the MGA by professional organizations, licensing authorities or self-regulatory bodies.

- *Advertising*

The agreement should require all market or promotional materials used by the MGA which refer to the insurer's products, trademarks and Logos, regardless of media, be pre-approved by the insurer prior to publication or distribution.

Principle Four - Active Oversight

Life insurers should monitor the performance of MGAs to whom they have selected to distribute their products or delegated authority.

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

Reviews of MGA arrangements should be periodically undertaken by the insurer's internal audit department or another independent review function, either internal or external to the insurer, provided it has the appropriate knowledge and skills.

Reviews should 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
- ensure the MGA has effective management controls over the services provided;
- verify the adequacy and accuracy of management information reports provided by the MGA; and
- ensure that MGA's personnel involved in providing the services are qualified and appropriately licensed.

Insurers should promptly act to correct any MGA problems or potential issues identified (for example those that may have been revealed by any audit or on-site visits, complaints or potential litigation or regulatory issues).

Performance monitoring for MGA will usually include

- Insurers should monitor arrangements to ensure that the service is being delivered in the manner expected and in accordance with the terms of the agreement.
- Insurers should have specific procedures in place to ensure on-going adherence by MGAs to relevant legislative requirements in all jurisdictions where the MGA's services are being provided.
- Insurers need to have clearly defined procedures, (including notification to regulators), to be implemented in the event that irregularities (such as fraud and dishonesty) are identified at a MGA.
- Insurers are expected to deal with non-renewal or cancellation of an agreement with a MGA in an appropriate manner.
- Insurers are expected to have a process to monitor their own management of MGA arrangements.

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 insurer's board of directors will always retain overall accountability for the MGA strategy and should receive periodic reports on whether it continues to meet the insurer's business objectives.

At least annually, the insurer should review each MGA to ascertain its ability to continue to deliver the service in the manner expected. In addition, insurers should review the MGA agreements to ensure they continue to meet the insurer's business objectives and mitigate associated risks.