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Dear Sir or Madam:

Re: Managing General Agencies (MGAs) Distribution Channel in the Life Insurance Industry

Thank you for the opportunity to comment on the position paper of the Canadian Council of Insurance Regulators (CCIR) entitled *The Managing General Agencies (MGAs) Distribution Channel in the Life Insurance Industry* (the Position Paper).

EXECUTIVE SUMMARY OF ADVOCIS' COMMENTS ON THE CCIR POSITION PAPER

I. OPENING COMMENTS

Advocis supports the CCIR's approach to risk-based, outcomes-focused regulation, as it is consistent with the fundamentals of principle-based regulation (PBR). The MGA field is an appropriate arena for enhanced PBR, given that its stakeholders generally share the same assumptions about appropriate behaviours and desired regulatory outcomes.

II. RESULTS OF CONSULTATION

1. Functions Outsourced to MGAs

Advocis strongly supports the Agencies Regulation Committee's (ARC's) recommendation for the adoption of the four Best Practices for insurer-MGA relationships. Advocis also encourages insurers and MGAs, when contracting with one another, to consider both the principles underlying and the relevant content of CLHIA Guideline G8, Screening Agents For Suitability and Reporting Unsuitable Agents*. Advocis believes that encouraging actors to adopt the principles contained in Guideline G8 is more consistent with principles-based regulation (PBR) than mandating the wholesale incorporation of the Guideline into contracts between private parties. In contrast to regulators relying on prescriptive rule-making, Advocis believes that it is preferable to encourage industry actors to adopt constantly improving industry best practices and observe guidelines based on foundational regulatory principles.*

2. Supervision of Representatives

Again, Advocis strongly supports ARC's recommendation that CLHIA Guideline G8 be used as a point of reference for the creation of contracts between insurers and MGAs. Advocis agrees that it is not in the consumer's best interest to move to a one-to-one supervision model, as in the mutual funds industry. Advocis agrees with ARC that MGAs should report questionable acts by representatives to insurers with whom the representative has a contractual relationship or does business. MGAs should have a process for investigating questionable acts by representatives and a related process for keeping the insurer properly informed. Advocis would support the creation of a central database accessible by consumers, MGAs and insurers which would store information about a representative's qualifications, licensing, and disciplinary information of benefit to stakeholders, including the public. With regard to the supervision of advisors, and in the interest of enhanced public understanding, Advocis believes that advisors should disclose to consumers the nature of the MGA business model with which they are engaged. Finally, Advocis strongly supports the proposition that contracting insurers and MGAs draft their contracts in accordance with the principles informing CLHIA Guideline G8.

3. Managing Conflict of Interest Principles

Advocis continues to support the use of the CCIR Principles for Managing Conflicts of Interest *and similar industry codes of conduct. Advocis endorses the conclusion by ARC that an advisor should follow CLHIA Guideline G14:* Confirming Advisor Disclosure*. Advocis believes that proper disclosure by the advisor is both necessary and sufficient for consumers to decide if the product recommendations and advice they receive is objective enough to provide them with the degree of subjective "reassurance" they seek as individuals. Finally, Advocis would support ARC in attempting to determine in what manner, and how effectively, agents are discharging their obligations when providing advice on the suitability of a product.*

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

Regarding complaint reporting, MGA-representative agreements should include the obligation for the advisor to report to their MGAs any complaints received. As well, insurers should expect MGAs to require agents to report client complaints and have a documented complaint-handling policy. Advisors should notify potentially affected parties – the insurer, the MGA, and their errors and omissions carrier – about complaints received. Finally, Advocis supports the adoption by stakeholders of ARC's Principle Three, which requires that the insurer-MGA contract clearly delineates the role MGAs have in notifying insurers and providing information to clients. Advocis believes, consistent with the flexibility and shared responsibility characteristic of PBR-focused jurisdictions, that there is a shared obligation on advisors, MGAs and insurers to report complaints.

5. Compliance with Privacy Legislation

Advocis agrees with ARC that no action is required on this front as existing privacy laws address this matter. Any breaches are subject to the jurisdiction of privacy commissioners. Of course, representatives are responsible for ensuring they comply with existing privacy legislation, as are MGAs and insurers. Advocis supports the adoption of ARC's proposed Principle Three, which envisions that the security and confidentiality policies adopted by an MGA be commensurate with those of the insurer and that notification requirements be in place

in the event there is a breach of security.

6. Who is watching over MGAs?
In contrast to a rigid one-size-fits-all approach to deal with MGAs, Advocis supports the CCIR's existing flexibility-based approach, so that the various MGA business models may continue to flourish under principles-based regulation and fulfil a diverse set of consumer and advisor needs. Advocis understands that the CCIR's approach is feasible as long as regulators are properly informed in a timely manner. Advocis therefore supports ARC and the CCIR in helping regulators develop better systems of identifying and classifying MGAs.

III. ARC RECOMMENDATIONS
By way of reducing the jurisdictional impact of regional differences, Advocis supports the implementation of these recommendations.

Insurer Relationship with MGAs
Advocis supports ARC's goal of harmonizing best practices in the governance and management of MGA agreements by insurers. The principles underlying CLHIA G8 Guidelines should be considered when entering into insurer-MGA contracts. MGAs should be encouraged to follow these standards by way of contractual obligation. Advocis further submits that the CCIR should consider ways in which to ameliorate the compliance costs borne by MGAs and insurance companies of routine insurance company audits of MGAs by encouraging the use of standardized audit forms and the sharing, whenever possible, of audit results. Standardized auditing would benefit all MGAs and insurance companies by reducing the duplication of effort while enhancing clarity and consistency.

Agent Supervision
Advocis supports parties making recourse to the G8 principles of agent supervision when drafting insurer-MGA contracts. Agreements drafted in accordance with those principles and other industry-accepted practices are a primary goal of the regulation of MGAs.

Product Suitability
Advocis supports ARC's further recommendation that regulators be allowed to conduct onsite examinations to ensure companies are in adherence to CLHIA Guideline G8 principles. Regular market conduct reviews should be undertaken by regulators to determine if insurers and their agents are making suitable product recommendations and providing consumers with adequate information to make informed decisions.

Information needs of regulators
Advocis supports ARC's recommendations that regulators be able to access the information needed to better understand the MGAs licensed in their jurisdiction – in particular, their business models and their role in the distribution of life insurance products.

IV. BEST PRACTICES FOR INSURER-MGA RELATIONSHIPS
Principle One – A Clear Strategy
Principle Two – Thorough Due Diligence

Principle Three – Well-defined Roles and Responsibilities
Principle Four – Active Oversight

Advocis believes that these principles (and the accompanying examples provided by ARC) are sufficiently flexible to provide life insurers with the ability to enter into a wide range of MGA arrangements. Accordingly, Advocis supports their adoption by MGAs and insurers as far as possible.

V. CONCLUDING COMMENTS
Advocis looks forward to assisting the CCIR in enhancing and harmonizing best practices in the MGA distribution channel.

Advocis: Who We Are

Advocis, The Financial Advisors Association of Canada, is the oldest and largest voluntary professional membership association of financial advisors in Canada. From our predecessor associations onwards, Advocis is proud to continue more than a century of uninterrupted history of serving Canadian financial advisors and their clients. Almost all Advocis members are dually licensed to sell life and health insurance and mutual funds and other securities. Many are the primarily owners and operators of their own small businesses that create thousands of jobs across Canada. With over 11,000 members organized in 40 chapters across Canada, and almost 6,200 in Ontario alone, Advocis serves the financial interests of millions of Canadians. Across Canada, no organization's members spend more time working one-on-one on financial matters with individual Canadians than us. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future

As a voluntary organization, Advocis is committed to professionalism among financial advisors, which is why Advocis members are required to put their clients' interests first. More particularly, Advocis members promote advisor professionalism by:

- adhering to the Advocis *Code of Professional Conduct*;
- observing and upholding proven standards of best practice;
- maintaining appropriate errors and omissions insurance to protect consumers;
- obtaining professional designations supported by a comprehensive curriculum and rigorous standards, including Advocis' Chartered Life Underwriter® (CLU) and Certified Health Insurance Specialist™ (CHS), and educational support for the attainment of the Certified Financial Planner® (CFP) designation; and
- participating in an ongoing basis in mandatory continuing education programs.

In terms of this submission, we would note that the CCIR is a key regulatory body for the insurance industry, and so its priorities and activities directly affect a significant number of Advocis members. Our following specific comments of the CCIR's paper therefore reflect the priorities of Advocis' members and their clients. Indeed, Advocis members are

a resource for insurance regulators and governments due to our long tradition of working cooperatively with regulatory stakeholders to ensure that consumers of financial services are adequately protected, have ample choice and access to professional financial advice, and that the financial advisory business continues to be an important part of Canada's economy. We are pleased to engage regulators such as the CCIR in meaningful dialogue and to work together to develop appropriate solutions to regulatory and consumer protection issues.

I. OPENING COMMENTS

Advocis supports the CCIR's willingness work with industry stakeholders to develop standards for MGAs so that market participants can know what is expected of them.[1] This process began when the Agencies Regulation Committee (ARC) released for public consultation in February 2011 an issues paper, entitled *Managing General Agencies Life Insurance Distribution Model* (the Issues Paper), which canvassed the following issues:

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, and
6. Who is watching over MGAs?[2]

These six topics remain the focus of the current Position Paper, and provide the basis for its "Issues Identified" text boxes, the four Recommendations, and the four Best Practices principles promulgated by ARC, all of which will be commented on below. For ease of reference, each item is commented on in the sequence in which it appeared in the Position Paper. Please note that throughout this document the terms "financial advisor" or "advisor" are used interchangeably with "agent" and "representative."

Principles-based regulation

In terms of the CCIR's risk-based, outcomes-focused approach to regulation, Advocis offers the following understanding of principles-based regulation (PBR), in order to better illustrate the comments submitted below. PBR involves a re-conception of the regulatory framework, from that of a one-to-one regulator-participant relationship with top-down direction and control, to that of a network of regulatory relationships informed by mutual trust, shared responsibilities and a commonality of interests. PBR is based on the assumption that regulated organizations will act in a manner leading to sanctioned outcomes *if* the regulatory principles are knowable in advance, comparatively relatively easy to adopt, complied with by competitors, and "bad" outcomes are not catastrophic to the financial industry as a whole – i.e., they do not result in unwarranted systemic risk.

[1] See the CCIR's adoption of the Risk-Based Market Conduct Regulation Committee's *"*Approach to Risk-based Market Conduct Regulation*"* (October 2008).
[2] CCIR Issues Paper, "Managing General Agencies Life Insurance Distribution Model" (February 2011), p. 2.

Advocis believes that MGAs are a suitable target for PBR. MGAs occupy a unique role in the "regulatory field," one which can be used to great effect in a PBR regime: as an intermediary between the insurer and the advisor, an MGA has a special vantage point on the advisor's business relations with a number of companies and therefore can often be the first to detect troublesome patterns of conduct, which may require regulatory review, or simply necessitate further training for the advisor.

PBR: when to regulate

The core tenets that should guide regulatory action on the part of those regulators, trade associations, and professional bodies who are committed to PBR are:

- to act only in the case of market failure, information asymmetries or matters of consumer protection;
- to identify the problem through detailed consultation and analysis; and
- to employ PBR responses unless there is clear evidence that, absent a prescriptive policy response, harm will be done to the market or consumers.

PBR: how to regulate

Once the need to act in a PBR-style-of-manner has been recognized, the next question is *how* to act. In this regard, it should be noted that an effective regulatory regime based on PBR will typically exhibit the following characteristics:

- the creation and adoption of high-level standards and principles which operate at broader level of generality than prescriptive and narrowly conceived rules;
- a reliance on constant improvement and adoption of industry best practice standards and guidelines;
- a commitment to robust stakeholder participation in the design of those standards and principles;
- an acceptance of increased self-regulatory responsibility by senior management of the regulated participant organizations to implement the standards and principles promulgated;
- an acceptance of increased responsibility by trade associations and other stake-holding professional bodies in enforcing established, agreed-upon standards and best practices to fulfill in actuality the regulatory principles; and, ultimately,
- a focus on an outcomes-based approach, which is concerned more with whether a regulated participant reaches a particular outcome that is sanctioned by the promulgated standards and principles (e.g., such as the proper screening of advisors by MGAs) than whether the participant abides by narrowly conceived and universally applied rules (e.g., whether advisors met fulfill the

appearance of having met the elements of a screening checklist administered by an MGA).

In order for a PBR-based regime to work to its full potential, market participants must be encouraged (and able) to embrace results-oriented principles in their own internal processes. This means that the PBR regulatory authority must tailor the principles to the organizational cultures and internal incentives of its regulated participants.

Under a functioning PBR regime, avoidance of a rule or policy by a regulated participant through a merely technical interpretation of a rule becomes nearly impossible. In this respect, PBR is "smarter" than a rules model of regulation because the regulated community has a greater interest and role to play in developing principles and ensuring that rogue industry participants are brought into line. In short, the regulation that is produced through PBR has a stronger market focus and is typically reflective of good business policy.

In the MGA field compliance has continued to evolve in a PBR-style manner. Awareness among advisors of their responsibilities to the consumer is quite high. The continuous improvement and adoption of best practices by advisors and MGAs to protect both their clients and their businesses is robust. The MGA as an organization provides a privileged level of oversight on its advisors under contract. For their part, MGAs and insurers work together to respond to potential concerns about advisor practices and conduct. Clearly, PBR is working.

II. RESULTS OF CONSULTATION

1. Functions Outsourced to MGAs

Advocis is pleased by the considerable consensus which emerged from submissions from all industry segments that the ultimate responsibility for tasks outsourced to MGAs rests with the insurer.

With regard to outsourcing to MGAs, the Position Paper listed the as identified issues worthy of comment:

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.[3]

[3] CCIR Position Paper, "The Managing General Agencies (MGAs) Distribution Channel In The Life Insurance Industry" (May 2012) p. 6.

Advocis' comment: Advocis strongly supports ARC's recommendation for the adoption of the four Best Practices for insurer-MGA relationships (briefly commented on below), and that, at a minimum, insurer-MGA contracts are properly informed by the foundational principles underlying CLHIA Guideline G8.

2. Supervision of Representatives

The supervision of the representative includes assessing agents' suitability prior to entering into a contract (i.e., screening) and supervising their ongoing conduct with consumers (i.e., monitoring). The results of ARC's request for comments on the February 2011 issues paper is an emergent consensus across the industry that oversight of individual agents is currently shared among parties. No single entity – insurer or MGA – holds a complete view of the totality of business dealings of an agent. That, broadly speaking, is the current state of affairs with regard to agent supervision.

The Guideline G8 and the responsibility to screen and monitor

Advocis is pleased by ARC's conclusion that "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."[4]

In this regard, Advocis notes that in Ontario, insurers have a legal responsibility to screen representatives for their suitability to carry on business as an agent, as well as to monitor their behaviour.[5] In other provinces, such as British Columbia, this is not stipulated in legislation or regulations, but is adhered to as a matter of sound business practice.

To help ensure a harmony of standards between provinces, the Canadian Life and Health Insurance Association (CLHIA) has issued CLHIA Guideline G8: *Screening Agents for Suitability and Reporting Unsuitable Agents.* ARC recommends that insurers who are members of CLHIA incorporate this Guideline into their policies and procedures.

In fact, ARC noted, in some jurisdictions there is:

> 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

[4] *Ibid.*, p. 8.

[5] See O. Reg. 347/04, s. 12 (1), (20 and (3): 12. (1) Every insurer that authorizes one or more agents to act on behalf of the insurer shall establish and maintain a system that is reasonably designed to ensure that each agent complies with the Act, the regulations and the agent's license. (2) The system referred to in subsection (1) must screen each agent for suitability to carry on business as an agent. (3) An insurer shall report to the Superintendent if it has reasonable grounds to believe that an agent who acts on behalf of the insurer is not suitable to carry on business as an agent.

> 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.[6]

Accordingly, Advocis supports ARC's recommendation that CLHIA Guideline G8 be a starting point in the creation of contracts between insurers and MGAs, in the event that the particular jurisdiction in which the contract is being proposed does not provide for: (1) the legal responsibility to screen advisors for their suitability to carry on business as an agent and, (2) to monitor their behaviour.

Advocis would note here that an *explicit requirement* that the text of CLHIA Guideline G8 be incorporated on a wholesale basis into insurer-MGA contracts is inconsistent with the understanding of PBR laid out above, particularly with regard to the acceptance of increased self-regulatory responsibility by senior management of the regulated participant organizations to implement agreed-upon principles.

Advocis is also in agreement with ARC's finding that:

> 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.[7]

Reporting of misconduct

ARC also noted that there were divergent views on who should report advisor misconduct to regulators. The CLHIA and most insurers felt that insurers should be the ones responsible to report misconduct, *after* the insurer has investigated the matter. Conversely, those from the MGA/agent side suggested that MGAs and insurers should both report any misconduct to regulators. ARC concluded 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. According to Guideline G8, the insurance company does not delegate regulatory reporting of unsuitable representatives.

Advocis agrees with ARC that MGAs should report questionable acts by representatives to insurers with which the representative has a contractual relationship, or does business with. MGAs should have a process for investigating questionable acts by representatives and should have a related process of keeping the insurer informed.

[6] Position Paper*, op. cit.*, p. 7.
[7] *Ibid.*, p. 8.

However, Advocis also believes that all actors in the MGA field – advisors, insurers, MGAs, and consumers – have a shared obligation to report misconduct to the appropriate party or authority. Indeed, PBR, informed by the various actors' best practice standards and their industry or association codes of professional conduct, demands that the reporting obligation be conceived of as a multiplicity of obligations, with an actor that discovers a questionable act being obliged to report it in a proper and timely fashion.

Creation of a Canada-wide database

ARC noted that stakeholder submissions made pursuant to the Issues Paper also showed strong support for a centralized cross-Canada database for the documentation of misconduct. Such a database would assist insurers and MGAs in considering the suitability of new applicants for contracts. It would also help consumers make more informed decisions about their advisors. ARC noted that CCIR has formed its Disciplinary Information Committee to look into the feasibility of such a database.

Advocis is in agreement with this idea. In the case of misconduct involving a representative who is dually licensed, Advocis believes that misconduct in one sector (i.e., securities) should be reported to the other sector(s) (i.e., insurance) in which the representative is licensed. Simply put, Advocis supports the cross-sectoral sharing of information as a matter of consumer protection.

Advocis therefore would be pleased to support the creation of a central database which would store information about a representative's qualifications, licensing and pertinent disciplinary information of benefit to insurers, MGAs and consumers.

With regard to the supervision of advisors, the Position Paper listed the following issues:

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.[8]
- 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.[9]

[8] *Ibid,,* p. 9.
[9] *Ibid.*, p. 9.

Advocis' comments: In the interest of enhanced public understanding, Advocis believes that advisors should disclose to consumers the nature of the MGA business model with regard to supervision of advisors. Such transparency can only work to the consumer's benefit.

Advocis would also like the CCIR to make available for review the evidence supporting the statement that "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" (emphasis added). With regard to the consumer's perspective on advisors, only a handful of anecdotal comments were provided to the CCIR in response to its February 2011 Issues Paper. In the main, these comments dealt with the elements of trust and professionalism, and not with consumer concerns over agent supervision *per se*: a representative example of this is the submitted comment that "discriminating consumers" are "genuinely confused as to how they can acquire the professional guidance they now understand they require and want to be able to trust."[10] Advocis would suggest that the public needs to be better educated on the available mechanisms most Canadian provinces have in place to enable consumers to determine if an advisor is licensed and therefore carries the appropriate errors and omissions insurance and, where required, has fulfilled mandatory continuing education requirements.

With regard to the second issue, Advocis strongly supports the proposition that CLHIA Guideline G8 should inform insurer-MGA contracts. Again, however, Advocis wishes to emphasize that it does not believe the wholesale importing of Guideline G8 into an insurer-MGA contract is consistent with the principles of PBR. Advocis' position is that the contracting parties, when drafting an agreement, should be *guided by* Guideline G8, and should *account for* in their contract the various eventualities contemplated within that Guideline which are applicable to their unique situation. But a requirement calling for the automatic incorporation of the entire text of the Guideline into a contract does not suggest to Advocis that the insurer and the MGA will necessarily fully review and make provision for the risks and problems unique to their one-to-one contracting situation. Turning the text of Guideline G8 into boilerplate text which will over time be unthinkingly taken for granted by the contracting parties may perversely cause more problems than it solves. Proper PBR demands a more rigorous and fact-specific coming to terms between the two parties.

3. Managing Conflict of Interest Principles

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

- Client's interests come first: Agents must put the interests of policyholders and purchasers ahead of their own;

[10] MGA Paper Submissions. "Stakeholder Submissions regarding Managing General Agencies Paper . (April 27, 2011), p. 13. Accessible at www.ccir-ccrra.org/en/init/agencies_reg/Complete _Package_MGA_Paper_Submissions_2011.pdf

- 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.[11]

With regard to conflicts of interest, The Position Paper offered the following issue for comment:

> **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.[12]

Advocis' comment: Advocis believes that proper disclosure by the advisor is both necessary and sufficient for consumers to decide if the product recommendations and advice they receive is objective enough to provide them with the degree of subjective "reassurance" they seek as individuals. However, Advocis would like to have the opportunity to review the evidence for ARC's conclusion that "*consumers seem to want additional reassurance* that they are receiving competent product recommendations and advice that is free from conflict of interest" (emphasis added). Based on the comments provided to the CCIR in response to its February 2011 Issues Paper, Advocis is unaware of any statistically significant portion of the public which holds the view that consumers "want additional reassurance" in this regard. Indeed, Advocis would like clarification on what is envisioned by the phrase "additional reassurance" for consumers. Advocis would reiterate that a vast amount of policies, requirements and legal documentation is currently in place to provide this reassurance, ranging from provincial insurance acts, insurer-MGA contracts, MGA disclosure documents, MGA compliance manuals, professional associations' codes of conduct, provincial insurance council requirements, and various needs analysis, disclosure and Know Your Client documentation.

Disclosure of commissions will not add to consumer protection

ARC noted that the general view is that these principles form part of industry codes of conduct and are the responsibility of the insurance agent. Stakeholders recognized that that commissions paid to MGAs by the insurer are not currently disclosed to consumers.

[11] Position Paper*, op. cit.*, p. 9.
[12] *Ibid.*, p. 11.

ARC concluded that the consultation process did not result in evidence that such disclosure would add to consumer protection.

As noted in its comments on the February 2011 Issues Paper, Advocis believes that an advisor should always comply with the three principles for managing conflicts of interest. More particularly, two specific instances arise in the MGA context:

- If an MGA influences the recommendations of an advisors, it should be disclosed to the consumer; and
- If an MGA requires an advisor do a certain minimum percentage of business with it, or if any other compensation mechanism creates a potential or real conflict of interest, then this should be disclosed to the consumer.

Disclosure based on CLHIA Guideline G14: *Confirming Advisor Disclosure*
Advocis believes that an advisor should follow the principles of CLHIA Guideline G14: *Confirming Advisor Disclosure*, which sets out a uniform approach for companies to confirm that advisors make sufficient disclosure. It is worth noting that this level of disclosure is consistent with Advocis' own *Advisor Disclosure Reference Document*; among other things, this approach would mean that an application is not processed by the insurer unless it is "in good order" and includes the client's signature on the application form and the representative's signature on the representative's report. The representative's report serves to confirm that the representative has made appropriate disclosures to the client.

In sum, then, regarding complaint reporting, most MGA-representative agreements include the obligation for the advisor to report to their MGAs any complaints received. As well, insurers have the reasonable expectation that MGAs will require their agents to report client complaints or have a documented complaint-handling policy. Advisors will notify potentially affected parties – the insurer and MGA – and their errors and omissions carrier – about complaints received. All of this is consistent with the mutuality of interest that characterizes and effective PBR regime.

Suitability of product recommendations
ARC found an absence of understanding in the marketplace about the specific obligations of an advisor when providing advice on the suitability of a product. However, Advocis would note that there is a body of case law on the standards expected of advisors in terms of assessing a client's needs and requirements; moreover, industry association codes, insurance council by-laws and codes of ethics do require that advisors first obtain information about a client's needs and only then make recommendations as to what would constitute appropriate insurance coverage.

Nevertheless, cases of unsuitable advice resulting in loss to consumers do occur and receive a good deal of media coverage. This has led ARC to conclude "that it is appropriate for regulators to confirm in what manner, and how effectively, agents are

discharging this obligation."[13] Given our support of evidence-based policy research, Advocis would be pleased to assist ARC and the CCIR in reaching a determination on the manner and effectiveness of the discharge by advisors of this obligation.

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

In sum, ARC found that regarding complaint reporting, most MGA-representative agreements seem to include the obligation for the advisor to report to their MGAs any complaints received. As well, insurers expect MGAs to require agents to report client complaints or have a documented complaint handling policy. Advisors will notify potentially affected parties – the insurer and MGA – and their errors and omissions carrier – about complaints received.

As noted above, Advocis believes that all actors in the MGA field – advisors, insurers, MGAs, and consumers – have a shared obligation to report misconduct to the appropriate party or authority. Indeed, PBR, informed by the various actors' best practice standards and their industry or association codes of professional conduct, demands that the reporting obligation be conceived of in a flexible multi-party manner in which parties share information and responsibility.

That said, Advocis in general supports the interpretations made by ARC on its research into this issue, as well as the resulting principles-based guidance ARC offers, which Advocis sees as in line with its own position on the typical process of complaints handling, which is set out below.

Consumer complaint against an MGA
If a mistake is made by the MGA and a client complains, the client will often first approach the advisor, since the client has a relationship with the advisor and is the client's point of contact. The insurer would also be known to the client and the client may choose to contact the insurer directly.

Consumer complaint against an insurer
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.

Role of the advisor regarding complaints
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. In addition, the advisor has a contractual obligation through its errors and omissions policy to notify its

[13] *Ibid.*, p. 10.

errors and omissions carrier. The advisor, therefore, notifies *all* relevant parties regarding any complaint that the advisor directly receives from the client.

The impact of the MGA is consumer-neutral

As noted, Advocis is in agreement with the conclusions reached by ARC regarding the role of MGAs in handling consumer complaints:

> There was consensus that the involvement of MGAs 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.[14]

With regard to complaint handling, ARC's proposed Principle Three offers specific guidance.

ARC's Principle Three: An obligation on MGAs to notify insurers and provide information to clients

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. Accordingly, ARC notes that MGA arrangements should be documented by a written agreement that creates well-defined roles and responsibilities. With regard to complaints, the Position Paper's proposed "Principle Three: Well-defined Roles and Responsibilities," states the following:

- *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 [proceed].[15]

Advocis believes that this reporting obligation essentially already applies to MGAs and that, while MGAs should be encouraged to incorporate this reporting obligation into their contracts, mandating it as a contracting term is both superfluous and contrary to the principles of PBR.

Expansion of the OLHI system?

ARC noted that there was no agreement that the OmbudService for Life & Health Insurance (OLHI) system should be expanded to cover complaints against

[14] *Ibid.*, p. 10.
[15] *Ibid.*, p. 20.

representatives and MGAs. The general view is that complaints against representatives should be taken to the appropriate regulator as it has 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. Advocis would welcome discussions concerning improvements to the complaint resolution process including the appropriate scope and mandate of the OLHI.

5. Compliance with Privacy Legislation

Client information collected by an advisor 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. ARC notes that it is unclear 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.

Advocis is in agreement with ARC's conclusion that no action is required as privacy laws address this matter and any breaches are subject to the jurisdiction of privacy commissioners. Representatives are responsible for ensuring they comply with existing privacy legislation, as are MGAs and insurers. Once again, ARC's proposed Principle Three is relevant here.

ARC's proposed Principle Three: contracting for confidentiality
As noted earlier, ARC's Principle Three recommends that an MGA's arrangement regarding confidentiality and security of client information be documented in a written agreement that addresses all elements of the arrangement. The agreement should be reviewed by the insurer's legal counsel. In terms of confidentiality and security, ARC states that:

> 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.[16]

Advocis would only note that insurance applications contain provisions to obtain permission to allow third-parties such as MGAs to handle personal information. This occurs when advisors obtain consent from the client to provide information to the MGA either in the engagement letter or as part of the advisor disclosure process regarding third parties to whom the information will be disclosed in order to process an application for products and services. Advocis would be happy to work with the CCIR to ensure that

[16] *Ibid.*, p. 21.

this is occurring in practice and/or to standardize this disclosure process, if the regulator deems it to be necessary.

6. Who is watching over MGAs?

This section deals with the main element of MGA oversight: regulators' supervision of MGAs. ARC noted that stakeholders confirmed 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, thereby making provincial licensing legislation applicable. Such legislation was passed long before MGAs became a central part of the life distribution model, and so there is no specific licensing category for MGAs in any Canadian jurisdiction.

Adovics would note that to a very real extent, and as is consistent with PBR, the MGA field is largely self-policing. The vast majority of brokers, for example, would "vote with their feet" if an MGA was not conducting its affairs in a manner consistent with regulatory policy. MGA principals and advisors would not be able to obtain professional E&O insurance and third party MGA insurance if they demonstrated a pattern of inappropriate, incompetent, criminal or negligent behaviours. Moreover, existing legal or regulatory procedures and documentary requirements – including provincial insurance acts and regulations, Financial Transactions Reports Analysis Centre of Canada (FINTRAC) audits, insurer audits, insurer-MGA contracts, MGA disclosure documents, MGA compliance manuals, professional associations' codes of conduct, provincial insurance council requirements, engagement letters, and the various voluntary and mandated needs analysis, disclosure and Know Your Client documentation – all work to ensure that a strong, multi-party system of countervailing review pervades virtually every aspect of the MGA field.

The MGA field is therefore characterized by a multi-level approach to the monitoring of the overall business practices of its participants. Oversight is provided by the existing regulation pertaining to the licensing of advisors, especially with regard to desired behaviours in terms of product suitability and conduct which accords with the best interests of the consumer. And of course most jurisdictions require professional liability insurance and a continuing education credit requirement as conditions of agent licensing. Next is the due diligence undertaken by MGAs and insurers contracting with a new advisor, which provides another layer of oversight on that advisor's suitability and qualifications, and includes background checks, referencing, and confirmation of appropriate licensing and E & O insurance.

The final level of oversight is that of the professional association: for example, Advocis, The Institute for Advanced Financial Education (IAFE), the Conference for Advanced Life Underwriting (CALU), the Canadian Association of Independent Life Brokerage Agencies (CAILBA), and the Independent Financial Brokers of Canada (IFB) all have codes of ethical conduct to which association members are expected to adhere; in the

case of Advocis and the IAFE, these include continuing education requirements and the obligation to act in the best interests of the client.

Advocis is pleased that ARC recognizes that there is a multiplicity of differing MGA business models and that the variegation of roles played by MGAs is seen by stakeholders and ARC as a positive. Advocis believes that PBR is best served by recognizing the flexibility of the MGA model, and accordingly agrees with ARC's endorsement that:

> [t]he industry in general does not favor a one-size-fits-all approach to deal with MGAs, but prefers the existing flexibility of various MGA business models 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.[17]

More specifically, ARC believes that to be able to monitor risks and effectively supervise in the marketplace, regulators must be informed about the business practices of their licensees. ARC gave the following examples of necessary licensee information:

- is the licensee licensed as an individual, a partnership or a corporation;
- is the licensee operating as a career agent or an independent agent;
- is the licensee associated to one or more MGAs and who those MGAs are;
- is the licensee an MGA itself, and if so, who are the insurers with whom it has agreements in place, and who are the agents?; or
- is the licensee an AGA, and if so, who are the MGAs with whom it has agreements in place?[18]

Advocis is in agreement with the concept of modifying the existing licensing framework to accommodate a mandated registry or reporting mechanism which would enable provincial regulators to access information ARC believes to be necessary for effective PBR. Minor amendments to current licensing documentation would be sufficient to enable the capture of relevant information (such as that contained in the bulleted points immediately above). Advocis would be pleased to be part of any discussion with ARC and other stakeholders to help ensure regulators have sufficient information to maintain an effective PBR-based MGA compliance regime.

In terms of issues identified in the regulation of MGAs, the Position Paper offered the following:

[17] *Ibid.*, p. 11.
[18] *Ibid.*, p. 12.

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.[19]

Advocis' comment: In order for a regulator to be able to identify and better understand the MGAs operating in its jurisdiction, it would be of considerable utility to require MGAs to be licensed or registered with the appropriate insurance regulator. Advocis is uncertain as to which jurisdictions within Canada are not at present able to readily identify the licensed agents *qua* agents operating within their purview. Advocis supports ACR and the CCIR in helping developing regulators develop better systems of identifying and classifying MGAs and identifying their principals and agents.

III. ARC RECOMMENDATIONS

In the Position Paper, ARC acknowledged that jurisdictional differences exist across Canada. By way of ameliorating the impact of these differences ARC therefore suggested that provinces considering implementing the recommendations below in a manner which accounts for, when necessary, any regional issues.

Recommendation 1: Insurer Relationship with MGAs. Insurers must have in place effective systems and controls whenever they use the services of an MGA.[20]

Advocis supports ARC's goal of harmonizing best practices in the governance and management of MGA agreements by insurers. The "Best Practices for Insurer-MGA Relationships" in Appendix 1 of the document is an excellent example of a regulator providing guidance in a way that supports PBR.

Insurer auditing of MGAs: costs of compliance
Many MGAs are currently engaged in routine yet resource-intense audits from multiple insurers, which results in a tremendous and inefficient duplication of information without yielding significantly enhanced consumer protection. Accordingly, Advocis strongly urges the adoption of a standardized form to be used in all insurer audits, with a special company-only section in the event that the auditing company needs production of certain specific information.

[19] *Ibid.*, p. 12.
[20] *Ibid.*, p. 13.

At the risk of repetition, it is worth noting again that such insurer auditing is in addition to existing legal-regulatory procedural and documentary requirements – including provincial insurance acts and regulations, FINTRAC audits, insurer audits, insurer-MGA contracts, MGA disclosure documents, MGA compliance manuals, professional associations' codes of conduct, provincial insurance council requirements, engagement letters, and various mandatory and voluntary needs analysis, disclosure and Know Your Client documentation.

Advocis would like to suggest an expansion of the principle underpinning the CLHIA's reference document *Screening Agents For Suitability and Reporting Unsuitable Agents: CLHIA Standardized MGA Compliance Review Survey (re: Guideline G8*). This document was designed to provide a means for insurers to assess the controls which they have delegated to MGAs in terms of screening and other compliance tasks. By standardizing the documentation required of insurers conducting audits, a significant reduction of the compliance burden on both insurers and MGAs would be realized, and instead of a duplication of auditing efforts, the saved resources of the MGA's and the insurer's compliance staff could be used for other pressing compliance matters.

Proposed streamlining of insurer audits

It was noted in the earlier section of this submission that, in order for a PBR-based regime to work to its full potential, market participants must be encouraged (and able) to embrace results-oriented principles in their own internal processes. This means that the PBR regulatory authority must tailor the principles it seeks to implement to the organizational cultures and internal incentives of its regulated participants.

Standardized auditing would assist all MGAs and insurance companies by reducing the duplication of effort and enhancing clarity and consistency. The use of a standard MGA audit form in periodic auditing by a representative selection of the MGA's contracted insurers would result in the generation of sufficient information for the remainder of that MGA's contracted insurers. The total pool of insurers contracted with that MGA would, on a rotating basis, yield a list of insurers slated to conduct full audits. With the results of these full audits shared with all of an MGA's insurers, inefficiencies due to duplication of effort would be eliminated.

For example, a standardized insurance company audit form could be adopted which indicates that if two or more insurance companies have conducted an audit within the last six calendar months, and if there has been no material changes in how the MGA carries on business (e.g., location, principal(s), overall state of the financial statements), and no triggering event, such as a merger or a substantiated complaint to a relevant regulator, then the need for any further scheduled audits by additional insurance companies of the MGA within the next three months would be considered unnecessary.

The information produced in the last six months could be shared, as appropriate, with those other insurance companies requiring audits as part of their ongoing business

practices. Obviously, in the event of a triggering action, such as a material change in how the MGA conducts its business, or a substantiated complaint by an insurer or other actor in the MGA field, this streamlined process of audit-sharing would be suspended and the current auditing regime would go back into effect.

The standardized insurer audit form would come with a special company-only section, in the event that a non-auditing company needs production of certain specific information. Each insurer which hasn't done a full audit in the time frame under review would therefore still remain free to do its own audit -- using the special company-only section – for any issues unique to it. This partial audit would be in complement to the shared contents of the MGA's other, fully completed audits.

If the sharing of audit statements among insurance companies is determined to pose too much risk in terms of privacy protection or exposure of business information or practices, then, as an alternative, the CCIR could recommend a model in which, after a company audit, any further audits scheduled within the next three months could be done with a pared-down or simplified audit form. Again, the result would be a lessening of the compliance burden on the MGA and its insurers, with cost savings ultimately passed on to the consumer.

In sum, the standardization of insurer audits of MGAs – and the elimination of unnecessary ones – would reduce unnecessary duplication of effort without sacrificing insurer confidence or impeding the overall monitoring and oversight of MGAs. Insures and MGAs would both share incentives to reach the same outcome, and their internal processes would be oriented toward attaining that outcome – a hallmark of effective PBR. The same regulatory outcome could be achieved with fewer resources – again, another hallmark of effective PBR. The result would benefit the key stakeholders: insurers, MGAs, regulators and consumers and bolster the business efficiency of the industry as a whole.

Recommendation 2: Agent Supervision. 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.[21]

As noted earlier, Advocis supports the concept of Guideline G8 principles informing the drafting of MGA contracts. As well, Advocis supports ARC's further recommendation that regulators be allowed to conduct onsite examinations to ensure companies are in adherence with Guideline G8 principles, as is already the case with regulatory audits from FINTRAC and provincial insurance councils. However, for the reasons adduced above with regard to insurer audits, Advocis notes that the benefits from using standardized compliance audit forms and processes cannot be overstated. MGAs should not – and in fact, some cannot – readily accommodate the employment of a different

[21] *Ibid.*, p. 13.

auditing process from each regulator (or insurer). Advocis therefore urges the CCIR to further explore possible streamlining of regulatory audits for MGAs.

Recommendation 3: Product Suitability. 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.[22]

Given the ongoing and now increasing trends toward product complexity and product convergence, Advocis supports this recommendation. Advocis believes that advisors have an important role in ensuring consumers have access to products suitable for their needs and have the information required to make informed decisions. Advocis is participating in the Joint Forum's current product initiative, phase one of which involves a review of how insurance companies design new products and create marketing materials. Moreover, the Ontario Securities Commission has included in its draft Statement of Priorities a renewed focus on product suitability, especially with regard to how advisors recommend complex products to consumers.

Recommendation 4: Information needs of regulators. 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.[23]

As noted above, to further enhance PBR, Advocis supports ARC's recommendations that regulators be able to access the information needed to understand the MGAs licensed in their jurisdiction – in particular their business models and their role in the distribution of life insurance products. Advocis would be pleased to consult with ARC or provincial regulators to help ensure regulators can effectively gather the necessary market intelligence.

Advocis would support the creation of a central database or registry to ensure regulator access to certain information on MGAs and advisors. In terms of a central facility for reporting and tracking substantiated complaints of advisor misconduct, Advocis submits the following comments:

- a national database for substantiated complaints and disciplinary measures would eliminate existing reporting gaps between sectors and jurisdictions and greatly improve the monitoring of advisors' and MGAs' business practices;
- to better reduce the risk of unwanted outcomes and increase consumer confidence, monitoring should be a shared effort and responsibility of all industry participants – regulators, insurers, MGAs and agencies;
- dually-licensed advisors should have their substantiated misconduct in one sector (e.g., securities) reported to other sectors in which the advisor is

[22] *Ibid.*, p. 14.
[23] *Ibid.*, p. 14.

licensed (e.g., insurance), since cross-sectoral sharing of substantiated complaints and proven misconduct will only benefit consumers; and
- appropriate safeguards must be in place to ensure that shared reporting of misconduct *only* results in measured and appropriate punitive or disciplinary action being taken against the "bad actor."

IV. BEST PRACTICES FOR INSURER - MGA RELATIONSHIPS

ARC has helpfully identified four best practices Principles[24] for use by life insurers when in drafting contracts with MGAs and otherwise transacting business with them:

- 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 to 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.

These principles, and the accompanying examples provided by ARC in the Position Paper, are sufficiently flexible to provide life insurers with the ability to enter into a wide range of MGA arrangements. Accordingly, Advocis believes that this four-part set of Best Practices be adopted by MGAs and insurers as far as possible, and that insurance regulators, where necessary, adjust their own PBR approaches to properly capture the deeper thinking underlying these principles.

V. CONCLUDING COMMENTS

We are pleased to provide the foregoing comments to you in response to the issues and questions raised in the Issues Paper. Advocis is committed to working with regulators and other stakeholders in order to ensure that an efficient and effective regulatory system is in place for the distribution of life insurance which protects consumers and enhances the efficiency of and Canadians' confidence in the our insurance marketplace. Moreover, Advocis looks forward to the assisting the CCIR in enhancing and harmonizing best practices in the MGA distribution channel. We would be pleased to

[24] *Ibid.*, p. 16.

meet with you to further discuss our issues and concerns. Should you have any comments or questions you wish answered before any such meeting, please do not hesitate to contact the undersigned, or email Ed Skwarek at eskwarek@advocis.ca.

Sincerely,

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