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

and to:

Canadian Insurance Services Regulatory Organizations (CISRO)

Dear Agencies Regulation Committee Members:

Re: Financial Advisors and Managing General Agencies

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

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

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

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

Definition and Role of MGA

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

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

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

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

Advisors often deal with more than one MGA in order to obtain the coverage that is most appropriate for the consumer¹. Insurers often contractually require an advisor² to place all business with that insurer through one MGA (for example, Insurer A requires that all business with Advisor A is placed through MGA A while Advisor A's business with Insurer B is placed through MGA B). Business is tracked by the MGA, insurer and advisor through the advisor's code.

Advisor's Contractual Relationship with an MGA

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

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

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

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

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

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

Oversight of Insurance Application by MGA

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

Continuing Education/Training

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

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

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

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

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

Compensation

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

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

Role of the Financial Advisor

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

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

Provincial Insurance Act and Associated Regulations

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

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

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

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

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

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

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

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

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

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

Product Suitability

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

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

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

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

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

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

Documentation/Retention

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

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

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

Proficiency, Continuing Education and Errors and Omissions Insurance Requirements

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

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

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

Insurer Responsibilities

Agent Suitability

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

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

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

Consumer Complaints

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

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

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

Compliance with Federal Legislation

Anti-Money Laundering and Anti-Terrorist Financing Regime Obligations

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

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

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

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

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

Privacy Legislation and Do Not Call Legislation

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

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

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

Yours sincerely,



Greg Pollock
President and CEO



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Chair, National Board of Directors