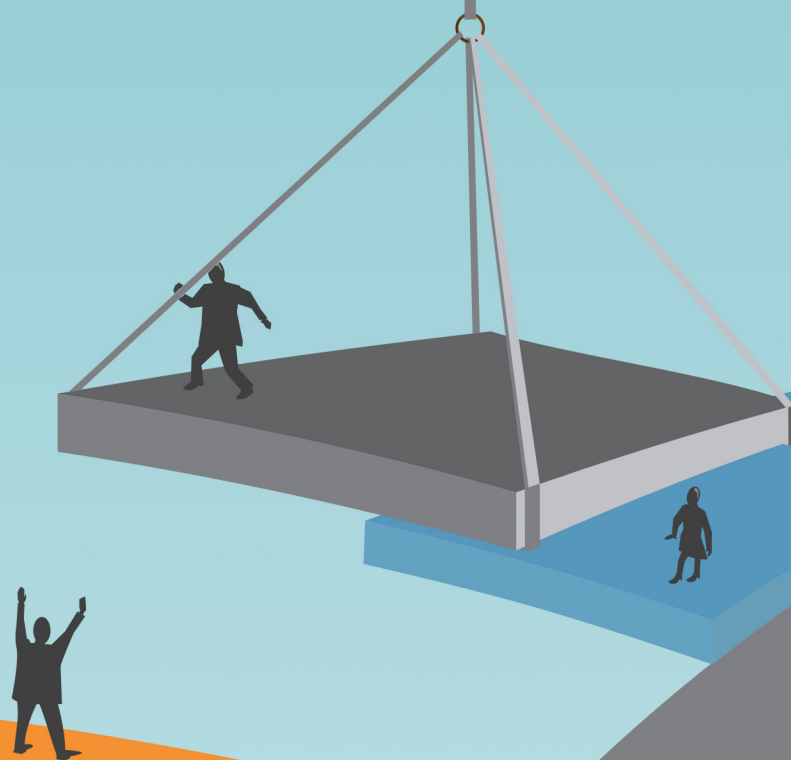


Improving Advisor Oversight

Helping consumers to be
sure they're secure



June 2017

About the CLHIA

The CLHIA is a voluntary association whose member companies account for 99% of Canada's life and health insurance business. The industry provides a wide range of financial security products such as life insurance, annuities (including RRSPs, RRIFs and pensions) and supplementary health insurance to over 28 million Canadians. It also holds over \$760 billion of assets in Canada and employs about 148,600 Canadians.

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Background

In 2016, the CLHIA Board of Directors endorsed a series of ten recommendations aimed at enhancing outcomes for customers and, in some cases, closing regulatory gaps related to the distribution of life insurance. These recommendations reflect an industry commitment to maintaining a strong customer focus and having policies and procedures that protect customers.

Recognizing distribution's unique and specialized role in treating customers fairly, the Board then considered how different distribution structures can better serve the needs of customers and meet insurers' compliance obligations. We found that, to meet consumer demands, insurers' distribution models have evolved over the years to include a variety of channels (e.g., MGA, national account, and career channels).

However, our existing regulatory structure for distribution, and the accompanying oversight obligations, most closely reflects a period when most insurers sold their products through a traditional career sales force.

In this paper we outline the industry's resulting position that a fundamental change is required to improve advisor oversight. Specifically, we believe that a regulatory licensing and oversight regime is required to establish distribution firms as distinct, licensable entities with certain advisor oversight responsibilities. Introducing such a regime would not change an insurers' existing compliance obligations, rather, it would provide the necessary tools to allow insurers to meet regulatory expectations for proactive compliance programs that are focused on fair outcomes for consumers.



Establishing a Licensing Regime for Distribution Firms

We are of the view that in today's multifaceted distribution market, a regulatory structure that does not fully include distribution firms may unintentionally lead to a silo-effect in oversight practices. Further, we believe that conducting oversight in silos makes it more difficult for regulated entities to meet expectations and introduces the possibility for oversight gaps to emerge between silos. Even in Quebec, which arguably has a stronger regulatory approach through recognizing distribution firms as separate entities, oversight gaps could emerge.

For example, in the MGA channel, it is not uncommon for an advisor to contract with multiple insurers through an MGA in order to access to a wide variety of insurance products for his or her clients. Under this scenario today, there may not be a single regulated entity in the distribution chain that has a fulsome view of the advisor's entire book of insurance business. While insurers have systems in place to monitor for advisor misconduct, the oversight done by each insurer in this scenario would be conducted in a silo that is limited to the business placed with that particular insurer. This may make it more difficult to detect advisor misconduct that may cross insurers, such as churning. By contrast, the MGA in this scenario is well-positioned to monitor for such misconduct.

Throughout Canada today, insurers and MGAs and other distribution firms are expected to have oversight practices designed to prevent, detect and address advisor misconduct. Over the years,

the industry has taken steps to clarify roles and responsibilities for oversight and to standardize industry practices (e.g., CLHIA Guideline G18, *Insurer-MGA Relationships*). Such guidance reflects the industry's belief that, in some cases, distribution firms may be in the best position to provide fulsome oversight of an advisor's activities.

We believe that formalizing such oversight responsibilities for distribution firms through a regulatory licensing regime would help to address any potential gaps in the structure. A regulatory licensing regime would also clarify the oversight responsibilities of insurers and distribution firms while acknowledging their respective practical oversight capabilities.

1 | Definition of a Distribution Firm

In our proposed model, a distribution firm would be defined as an MGA, national account or an affiliated entity within an insurer that handles relations with career agents or independent agents dealing directly with the insurer. This definition would be supported by a regulatory licensing regime setting out a clear accountability role for these entities.

2 | Licensing & Standards

The licensing regime for distribution firms would establish minimum standards for oversight of advisors and clarify the accountability for entities engaged in distribution. Under such a system, a distribution firm that failed to carry out effective oversight could lose its licence.



These standards should address the following:

- adherence by both the distribution firm and all its advisors to the insurer's code of conduct (or its own if it has been reviewed and approved by the insurer);
- advisor screening;
- on-going advisor monitoring (e.g. following needs-based sales practices, providing appropriate disclosures, etc.);
- reporting concerns about the suitability of an advisor to the regulator;
- consumer complaint handling and tracking;
- adherence to all legislation and regulation (including insurance laws and laws relating to money laundering, privacy and safeguarding of information, telecommunications and anti-spam);
- adequacy of errors and omissions insurance (especially as this may vary from statutory minimums); and
- adequacy of planning and resources for business continuity.

Much of this oversight occurs today through insurer and distribution firm oversight practices. The point of the licensing regime would be to set minimum standards and establish accountability among licensed entities.

3 | Roles & Responsibilities: Advisors, Distribution Firms & Insurers

Advisors

In addition to existing responsibilities, each advisor would be required to:

- designate a primary distribution firm;
- identify all distribution firms they place business with; and

- sign an agreement for information sharing between the distribution firms they place business with.

Of course, a distribution firm identified as an advisor's primary distribution firm would have to agree to this designation and take on the responsibility of a primary distributor.

Primary distribution firms

In addition to its existing oversight responsibilities as a distribution firm, the primary distribution firm would be responsible for carrying out prescribed oversight functions in relation to advisors who designate it as their primary distribution firm. Specifically, the primary distribution firm would:

- be the first point of contact for any regulatory concerns related to the advisor;
- be responsible for supervising the entire business of the advisor so as to understand all of the services being provided by the advisor to the client;
- inform and express any concerns about advisors to the other distribution firms those advisors place business with;
- review an updated *Advisor Screening Questionnaire* submitted by the advisor at the time of license renewal;
- select agents and conduct the random practice reviews, on an annual basis; and
- where concerns involve multiple distributors, co-ordinate investigations and follow-up.

In the case of random practice reviews, the primary distribution firm would, in addition to reviewing its own business with the agent, coordinate to receive the appropriate information from the other distribution firms where the agent places

business and incorporate this information into the review. The primary distribution firm would also share with those other firms any practice review concerns it finds.

Secondary distribution firms

In addition to their existing oversight responsibilities as a distribution firm, secondary distribution firms would have new commitments, including being required to:

- inform and express any concerns about advisors to the advisor's primary distribution firm;
- share data to support random practice reviews as requested by primary distribution firms;
- cooperate, as needed, in investigations by primary distribution firms; and
- take into account any review findings or concerns raised by a primary distribution firm.

Insurers

Insurers accepting business directly from independent advisors today would need to be licensed distribution firms under this approach so that an independent agent could designate an insurer's distribution firm as his or her primary distribution firm.

4 | Accountability

Distribution firms should be accountable for the conduct of advisors placing business through them. Where an advisor is attached to multiple firms, each of these would retain responsibility for oversight of activity related to it. In addition, the new responsibilities attached to primary

and secondary distribution firms would ensure that information is shared effectively for the purposes of practice reviews and concerns about advisor conduct. Insurers would also continue to have legislative and regulatory oversight responsibilities. However, within the context of a regulatory licensing regime, there would be a clear and consistent accountability role for distribution firms.

Attached as Appendix I is a visual overview of how this enhanced oversight might look.

Other Industry Initiatives to Improve Advisor Oversight

In addition to the model outlined above, the industry is pursuing a number of initiatives to enhance advisor oversight practices under the current regulatory structure. Our intention with each of the following initiatives is to establish standard expectations of CLHIA members' advisor oversight practices through industry guidelines. Again, we believe the nature of these new standards is reflective of regulatory expectations that modern compliance programs should incorporate proactive oversight practices.

1 | Awareness

Insurers should have on-going communication with advisors to inform them of regulatory requirements, the industry practices that address those requirements, and how they can adopt

those practices to achieve fair outcomes for their customers. Specific initiatives that could be implemented to improve awareness include: publishing articles about disciplinary hearings and ethics, speaking on industry practices at advisor compliance conferences, developing a standard checklist of advisor compliance obligations, and asking advisors to make an annual attestation of compliance with codes of conduct.

2 | Industry-Wide Solution for Routine Compliance Monitoring

Insurers should adopt an industry-wide solution as a standard oversight process to monitor advisor compliance with statutory licensing requirements. In order to fully realize the potential for effective and efficient oversight,



universal participation of advisors, insurers and MGAs in an industry-wide solution is necessary. To achieve this goal, it may be necessary for such a system to offer different levels of service so that it optimizes the value for insurers with differing business models.

3 | Practice Reviews

The current best practice for insurers to conduct on-site advisor practice reviews should become an industry standard. Such reviews should be used to confirm that advisors are complying with requirements related to disclosure, continuing education and errors and omissions insurance. Reviews can also be used to confirm that advisors are documenting their fact finding, needs assessments and recommendations as required for needs-based selling. It should be noted that under the current regulatory structure, reviews are restricted to the business that an advisor places with the insurer conducting the review.

4 | Identified Risks

Beyond the trending and red-flagging activities currently conducted by insurers, the industry should – through CLHIA – monitor the distribution environment to identify new risks and advise members of ways to manage these in their oversight practices. Two recent examples of potential risks that have been identified and discussed within the industry are deferred sales charge purchases for clients over a certain age and eligibility for discounted high net worth fees.

5 | Record of Disciplinary Decisions

A record of insurer disciplinary decisions about advisors should be maintained in a clearinghouse,

with due consideration to privacy and other issues, that can be accessed by insurers. Such a system would enable insurers to:

- identify advisors who fail to declare, through the *Advisor Screening Questionnaire*, problems they have had with previous insurers;
- identify all of the past and current insurers that an advisor has contracted with; and
- notify other insurers about an advisor with whom they have a contract.

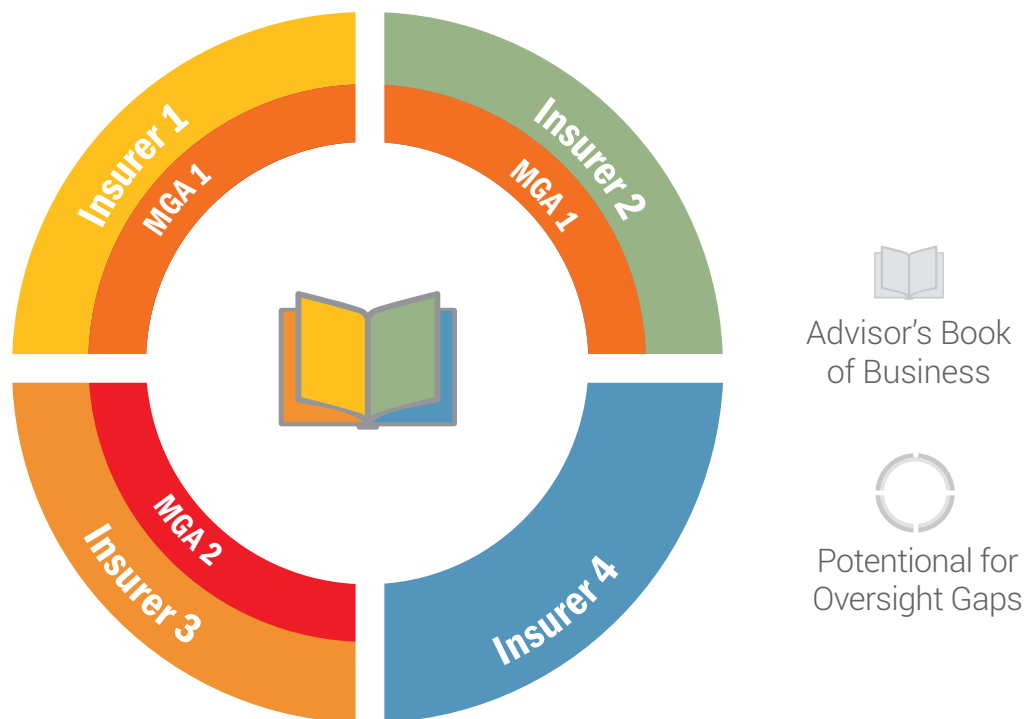
It should be noted that to establish such a system, existing contracts with advisors would need to be amended to provide for the advisor to consent to having this information recorded.

Conclusion

The life and health insurance industry believes that the initiatives above will improve advisor oversight within our existing regulatory structure. In addition, we believe that distribution firms should be incorporated into a regulatory licensing and oversight regime, and will work with regulators and the advisor community to pursue this change. Such a regime would recognize our shared interest in ensuring fair outcomes for consumers who, now more than ever, look to our industry to help ensure that their financial futures are secure.

Appendix I

Current Oversight Model



Proposed Oversight Model

