INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

APPLICATION PAPER ON APPROACHES TO SUPERVISING THE CONDUCT OF INTERMEDIARIES

NOVEMBER 2016

About the IAIS

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions in nearly 140 countries. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets. In addition to active participation of its Members, the IAIS benefits from input in select IAIS activities from Observers representing international institutions, professional associations and insurance and reinsurance companies, as well as consultants and other professionals.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), founding member and co-parent of the Joint Forum, along with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

About IAIS Application Papers

Application Papers provide additional material related to one or more Insurance Core Principles, including actual examples or case studies that help practical application of supervisory material. Application Papers could be provided in circumstances where the practical application of principles and standards may vary or where their interpretation and implementation may pose challenges Application Papers can provide further advice or recommendations to supervisors on how supervisory material may be implemented.

This paper was prepared by the Market Conduct Working Group in consultation with IAIS Members.

The publication is available free of charge on the IAIS website (www.iaisweb.org).

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1. Introduction

1.1. Background and purpose

1. Intermediaries' interface between customers and insurers gives them a key role in building and justifying public trust and confidence in the insurance sector, in particular through their conduct and competence. Supervisors set requirements to encourage and protect this key role; it is therefore important that licensing and conduct standards for intermediaries are appropriate and sufficient. Intermediaries can also promote consumer protection and financial awareness by assisting customers in making better informed decisions about the products that they buy.[1]

2. In view of their key role it is important that intermediaries conduct their business with due skill, care and diligence, apply adequate and appropriate governance, act in the best interests of their customers, and be subject to enforceable supervisory standards.

3. The IAIS's Insurance Core Principles (ICPs) provide a globally accepted framework for the supervision of the insurance sector, including the intermediary segment.

4. This Application Paper documents ideas on approaches that IAIS members may wish to consider when developing or revising a regime for the supervision of intermediaries, including when implementing ICP 18 (Intermediaries) and the relevant aspects of ICP 19 (Conduct of business), and incorporating them into their broader supervisory frameworks.

5. This paper supplements the IAIS's *Application Paper on Approaches to Conduct of Business Supervision.*[2] Whilst that paper focuses on conduct of business by insurers, this Application Paper addresses conduct of business by intermediaries, reflecting the fact that customers should be protected equally regardless of whether they obtain cover directly from an insurer or through an insurance intermediary. The supervisory framework should take account of all relevant industry participants, to ensure fair treatment of customers.

1.2. Survey on intermediary supervision

6. To obtain further information on approaches to the supervision of intermediaries, the IAIS conducted a survey ("the intermediary survey"),[3] asking questions relating to participating jurisdictions' supervisory framework for intermediaries. More than 60 IAIS Members participated in the survey. The survey covered:

- the overall framework for the supervision of intermediaries;
- relevant market statistics;
- whether (and in what way) there was a different approach to different types of intermediary; and
- supervisory requirements, including in relation to remuneration, advice, disclosure and advertising.

7. The survey enabled the IAIS Market Conduct Working Group to gather valuable input on supervisory practices, details about specific markets and also on trends and challenges that jurisdictions face when supervising insurance intermediaries.

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[1] See ICP 18.0.18-21

[2] Available on the IAIS website at: http://iaisweb.org/index.cfm?event=getPage&nodeId=25248

[3] Conducted alongside a self-assessment and peer and review exercise on ICPs 18 & 19.

8. Various examples of approaches to the supervision of intermediaries discussed in this paper are drawn from the survey responses. Relevant aspects of survey responses are highlighted or summarised in text boxes.

1.3. Structure of this application paper

9. This paper is structured as follows:

- Section 2 describes the different types of intermediaries and the diversity of intermediation.
- Section 3 discusses approaches to intermediary supervision within the context of the overall supervisory framework.
- Section 4 outlines supervisory requirements and approaches that promote good conduct of business by intermediaries, with reference to the requirements of ICPs 18 and 19.

2. Intermediation and types of intermediaries

10. An insurance intermediary may be any natural person or legal entity that engages in insurance intermediation, which the IAIS Glossary defines as the activity of soliciting, negotiating or selling insurance contracts through any medium.[4] In practice however, different jurisdictions use varying definitions of an intermediary or intermediation, according to jurisdiction-specific context and conditions.

11. While insurers can use various distribution channels to market and sell insurance products, this paper focuses on the use of insurance intermediaries.

2.1. Types of insurance intermediaries

12. Intermediaries generally fall into two categories,[5] acting either primarily on behalf of the customer or primarily on behalf of the insurer.

13. Where the intermediary acts primarily on behalf of the insurer they are often referred to as “agents”. Such intermediaries may act for a single insurer (sometimes referred to as “tied” or “captive” agents) or represent several. The products they can offer may be restricted by agency agreements with the insurer(s) concerned. Agents typically do not provide advice about insurance options on the market other than those of the insurer(s) with whom they have agency agreements.

14. Where the intermediary acts primarily on behalf of the customer, they may be deemed independent of the insurer(s) whose products are sold. Often referred to as “brokers”, such intermediaries are able to select products from those available within a defined pool or across the market. Depending on an individual jurisdiction’s market and legal context, an intermediary promoting itself as giving independent advice may be required to meet certain standards to demonstrate their independence, for instance by receiving no or limited remuneration from insurers and/or by comparing a large range of products available on the market.[6]

15. There can be more than one intermediary involved in the “chain of intermediation” for one risk or customer. In this respect, ICP 18 is intended to address all activities performed within the chain of intermediation for the conclusion or performance of an insurance contract. Responsibility for different activities in the chain needs to be appropriately allocated and documented between the intermediaries and insurers involved. For instance, in certain jurisdictions the insurer is not only responsible for manufacturing the product, but is also responsible for the marketing and distribution strategy of this product, to make sure it is sold to customers within the target market, even if the product is distributed through a third party. Ultimately, the customer must be in a position to know where to turn in the event of a claim, complaint, or for information or advice. The nature of the distribution chain should not have a detrimental impact on fair outcomes for customers.

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[4] Solicit" means attempting to sell insurance or asking or urging a person to apply for a particular kind of insurance from a particular company for compensation. "Negotiate" means the act of conferring directly with, or offering advice directly to, a purchaser or prospective purchaser of a particular contract of insurance concerning any of the substantive benefits, terms or conditions of the contract, provided that the person engaged in that act either sells insurance or obtains insurance from insurers for purchasers. "Sell" means to exchange a contract of insurance by any means, for money or its equivalent, on behalf of an insurance company.

[5] See ICP 18.0.9

[6] In some cases, agents who meet these types of requirements are regarded as having a certain degree of independence, despite their status.

Example: France

The ACPR issued a recommendation in 2014 regarding agreements on the distribution of life insurance policies (Recommendation 2014-R-01 of 3 July 2014).[7]

In the case of distribution chains, due to the large number of participants, the link between the insurer and the policyholder is increasingly remote. For example, the intermediary acting as primary point of contact with the insurer ("the primary intermediary") may differ from the intermediary acting as point of contact with the customer ("the distribution intermediary"). Moreover, in the majority of cases, there is no agreement directly linking the distribution intermediary to the insurer.

As a result, in order to be effective and meet the legislator's objectives, agreements between insurance intermediaries and insurers should include provisions for cases where more than one intermediary is involved in the distribution process. They should specify that a separate agreement will be needed for each distribution intermediary regarding the process of validation and/or use of marketing materials and the communication of the information necessary to understand all the characteristics of the insurance policy. Furthermore, the initial intermediary should ensure that the provisions of the agreement it draws up with each distribution intermediary are compatible with the provisions of the agreement signed with the insurer.

16. Some intermediaries, such as wholesale intermediaries, do not have direct contact with the customer but act with other intermediaries to place business with insurers. Even though they do not necessarily deal directly with the purchaser of insurance, they perform one or more of the functions in the chain of selling, soliciting or negotiating contracts of insurance.

17. Supervisory requirements and approaches may differ depending on the nature of the activities performed by intermediaries, the types of products they distribute, the types of customers they serve, the nature of the service provided (for instance, whether sales are on an "advised" or "execution only" basis) and the nature of their legal relationship with the insurer(s) concerned.

2.2. The diversity of intermediation markets

18. The nature and scope of intermediation within individual jurisdictions is influenced by a range of factors including local tradition, culture, legal regime, language differences and the degree of insurance market development.[8] While some jurisdictions share common features, others operate with significant differences. There is a great diversity of intermediation markets among IAIS Members. This heterogeneity is apparent in two main aspects: the diversity of the structure of intermediation markets and the diversity of intermediaries.

19. The number of insurance intermediaries operating within different markets varies significantly from one jurisdiction to another. This may be influenced by the composition of the insurance market itself; in some cases, insurers may favour particular distribution models for particular products. Similarly, depending on the product, some customers may favour using intermediaries or going directly to an insurer. These preferences may vary across insurance product lines – for example, in some cases customers are more likely to opt for direct models in respect of general insurance than for life or investment products. The needs and preferences of customers vary from one market to another. In setting its distribution strategy, the insurer takes these factors into account in determining the appropriate distribution channels.

20. Furthermore, individual markets can be heterogeneous because of the diversity of types of intermediaries operating within that market.[9] Some intermediaries are large enterprises in terms of business volume and staff numbers; others are of a less substantial

[7] https://acpr.banque-france.fr/fileadmin/user_upload/acp/Fichiers_EN/Recommandations_et_fichiers_DCPC/Recommendation-2014-R-01-of-the-ACPR.pdf

[8] See ICP 18.0.4

[9] See ICP 18.0.6

size, sometimes being sole traders or small businesses. As previously mentioned, an intermediary may be a legal or natural person, although in some jurisdictions the applicable framework dictates permissible status.[10] The mix of these intermediary types in the market differs from jurisdiction to jurisdiction.

21. Responses to the IAIS survey confirmed that the activities of intermediaries can range from offering simple, non-life products to complex products, such as unit-linked life insurance. The range of products and services they sell can be broad or restricted. They can sell products to retail or non-retail customers or be wholesale or reinsurance intermediaries. Geographically, the activities of intermediaries may be concentrated or widespread.

22. Distribution channels can include a variety of partners that are not traditional financial services players – such as car dealerships, post offices, retailers and travel agents acting as intermediaries by offering insurance related to the primary goods and services they sell.

2.3. The emergence of new distribution channels

23. The evolution of technology is changing customer expectations and preferences and the nature of insurer and intermediary interactions with customers. Insurers and intermediaries are adapting their business models to this environment in the marketing, distribution and servicing of insurance. Intermediaries' communication with customers has transformed well beyond traditional face-to-face communications and distance communications (such as telephonic communications and hard-copy mailings) to online "real time" communication and selling including e-mails, internet websites, mobile phone applications and social media.

24. The rapid growth in digital commerce has contributed to the rapid development of direct online selling of insurance by insurers. It has also led to questions about the adequacy and effectiveness of traditional regulatory and supervisory frameworks, including requirements relating to licensing, disclosure, promotions, marketing and advertising. As new distribution channels develop, supervisors may need to adapt their regulatory and supervisory approaches to deal with new and emerging risks to ensure that consumers are adequately protected. For example, some supervisors have considered banning certain types of online activities where they deem such activities could have a detrimental impact on customers.

25. On the other hand, regulation and supervision should not impede appropriate innovation, competition or ease of access, efficiency and convenience offered by technological advancements.[11] Supervisors are increasingly faced with the challenge of balancing these advantages against the need for customers to receive an appropriate level of protection regardless of the distribution channels and technological innovations used.[12]

[10] While ICP 18 only refers to two types of intermediaries – agents and brokers (see ICP 18.0.9) – individual jurisdictions often use more categories.

[11] Discussed further in the IAIS Issues Paper on Conduct of Business Risk and its Management, available at: http://iaisweb.org/index.cfm?event=getPage&nodeId=25248.

[12] See for instance the illustration of disclosure specific to Internet sales – ICP 19.5.17

3. Approaches to intermediary supervision

3.1. Specific features of intermediary supervision

26. Although the overall objectives of supervision of intermediaries and that of insurers are aligned, their respective roles in the insurance sector and the insurance product life cycle and other factors, such as the characteristics of the intermediation market, mean that there are typically differences in the approach to supervision. Some relevant considerations include the following.

27. **Focus is mainly on conduct of business, not prudential issues**: In the case of insurers, the overall supervisory framework should strike a balance between prudential supervision and conduct of business supervision.[13] The main supervisory focus for intermediaries is usually on conduct of business issues. To the extent that the supervisor has an interest in the financial soundness of intermediaries, this will usually be for purposes of securing adequate operational capacity and liquidity so that the intermediary can operate efficiently. Where the intermediary handles customer funds, the supervisor requires appropriate safeguards to protect such funds.[14] These financial management requirements are different from the prudential requirements imposed on insurers to enable them to fulfil their contractual commitments to policyholders. It follows that, when applying a risk-based approach to intermediary supervision, the supervisor's focus will be more on conduct risk indicators[15] than on prudential or financial soundness indicators.

28. **Supervision by different authorities or different departments within an authority**: In certain jurisdictions intermediaries and insurers are supervised by different authorities or different departments within an authority. In a "twin peaks" supervisory model, the conduct supervisor will often be required to supervise the intermediation of a broader range of products than only insurance.[16]

IAIS Members were asked about the authorities responsible for intermediary supervision

Responsibility sharing varies by jurisdiction, but the majority of respondents have direct authority to supervise intermediaries. In some jurisdictions, a market conduct authority and a prudential authority share responsibilities. Two jurisdictions reported that local trade authorities have a direct supervisory role. Other jurisdictions stated that a different authority also responsible for anti-money laundering and combating the financing of terrorism has a direct role. A few jurisdictions stated that other authorities, such as an authority for data protection and an authority for consumer protection share responsibilities from each perspective. In several jurisdictions, a self-regulatory organisation or the central body of industry groups have a role in monitoring intermediaries whilst the insurance supervisory authority retains its authority to supervise intermediaries. In a few jurisdictions, a securities authority also has an oversight role.

29. **The inter-relationships between insurer, intermediary and customer:** The very nature of intermediation means that the intermediary acts as a "go-between" for the insurer and the customer/policyholder. The supervisor should consider the typically tri-partite relationship between the customer, the intermediary and the insurer concerned. The policyholder is a customer of both the insurer and the intermediary. As a result, the overall supervisory framework needs to take adequate account of these inter-relationships to ensure fair treatment of customers. In cases where the supervision of insurers and that of

[13] Linkages between prudential and conduct of business supervision are discussed in the IAIS *Issues Paper on Conduct of Business Risk and its Management*, see section 2.1.

[14] See ICP 18.6.

[15] Conduct risk indicators are discussed further in the IAIS *Issues Paper on Conduct of Business Risk and its Management*.

[16] Where there are large numbers of intermediaries in a jurisdiction, this can sometimes be an influencing factor in how responsibility for intermediary supervision is allocated.

intermediaries is allocated to different authorities, or different divisions within the same authority, appropriate and effective coordination is crucial.

30. **Proportionality**: The supervisory framework for intermediaries should consider issues of proportionality and flexibility. In most cases, there is a considerably higher number of intermediaries operating in a jurisdiction than insurers, many of which may be very small. As noted in Section 2.1, the nature and scale of different intermediary business operations is also typically much more diverse than it is for insurers. Equally, the range and complexity of insurance products offered by different intermediaries is likely to vary significantly, as are the different types of customers served (ranging from less financially sophisticated retail customers to professional or commercial customers). Proportionality should be driven by the consumer protection objective.

> Example: <u>Netherlands</u>
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> Intermediaries are required to pursue an adequate policy that safeguards controlled and sound business operations. This shall mean that measures are taken to prevent the financial service provider or its employees from committing offences or other transgressions of the law that could damage confidence in the financial service provider or in the financial markets. It is, however, the intermediaries' responsibility to fulfil this requirement. In addition, there is no obligation on how this requirement should be fulfilled (principles-based). The reasoning for placing this responsibility upon the intermediary, as well as the principles-based requirement, is to adequately take proportionality into account: risks that should be addressed differ between organisations, in size as well as impact.

31. Without jeopardising consumer protection or compromising requirements for appropriate conduct and compliance, supervisors should take into consideration that their licensing and supervisory requirements do not impose unreasonable barriers to entry for small or emerging intermediary businesses and thereby limit the accessibility of insurance coverage to consumers.

32. Consideration should be given to proportionality in respect of transitional arrangements and implementation when new requirements are introduced, in order that customers' access to products and services does not suffer unnecessarily.

Proportionality principle

> - In the majority of the respondent jurisdictions, the legal frameworks do not explicitly take into account size of operations and nature of businesses of intermediaries; however, in many jurisdictions, size and nature of business are taken into account in their supervisory approaches. Many of them take a risk-based approach and focus on larger, more complex and riskier business.
> - In some jurisdictions, the legal framework recognizes a proportionate supervisory approach that takes into account the size of operations and nature of business of intermediaries.

33. **Broker vs agent models:** The nature of the inter-relationships discussed in paragraphs 12 to 14, and the legal responsibilities of the parties concerned, will also depend on whether the legal framework in the jurisdiction distinguishes between brokers and agents. Where this distinction applies, the supervisory framework – including the intermediary licensing framework (discussed in more detail in section 3.3) – will need to accommodate these differences, including with regard to the potential for conflicts of interest.

34. In light of the inter-relationships discussed in paragraph 29, different jurisdictions have different supervisory expectations regarding insurer responsibility for the conduct of insurance intermediaries. Where a distinction is applied between brokers and agents, a common approach is to regard the insurer as responsible for the conduct of its agents, who are regarded as acting on the insurer's behalf, whereas brokers are regarded as acting primarily for the customer, with the result that the insurer is not expected to accept entire responsibility for the broker's conduct.

35. Some supervisors are revisiting this traditional approach by placing greater responsibility on insurers to ensure the fair treatment of customers by intermediaries – including where distribution is through brokers. The thinking in these cases is that the insurer elects the distribution channel used to distribute its products to its customers. It is therefore reasonable to expect the insurer to bear at least some of the responsibility for the outcomes delivered to customers by such channels and take an interest in how and to whom its products are being sold. The same reasoning may apply to intermediaries using distribution channels. Examples of insurer responsibilities in this regard include responsibility for carrying out appropriate due diligence before contracting with a broker, responsibility for ensuring the broker has been trained or accredited on the insurer's products, and/or responsibility for monitoring aspects of the broker's conduct (including monitoring any customer complaints against the broker) and mitigating risks to customers appropriately. Importantly, this shift is not about undermining or diluting the intermediary's responsibility for its own conduct. Indeed, in many cases the intermediary and the insurer will share responsibility. Where the nature of the respective responsibilities differ, they can be seen as complementary, providing a double safety net to the customer.

Example: <u>Québec, Canada</u>
Under the Guideline on Sound Commercial Practices, the supervisor states that, regarding the empowerment of stakeholders, in the provision of products and services, the institution takes, upon first contact with the customer, a commitment to him and holds it to the extinction of all its obligations, regardless of whether the distribution network is or is not independent of the institution. In this regard, the institution should adopt conduct that ensures the fair treatment of customers at all stages of their contractual relationship. Accordingly, the institution should ensure compliance process control upon the supply of products and services (eg choice of intermediaries, contractual agreements, and monitoring service delivery)

36. **Potential for conflicts of interest**:[17] Conflicts of interest are inherent sources of conduct risk for intermediaries, given their role as "go-between" for the insurer and the customer. Intermediary supervision is likely to have a particular focus on the identification and management of conflicts of interest and related risks.[18]

3.2. The impact of market diversity on approaches to supervision

37. In light of market diversity, supervisors categorise intermediaries in different ways. The majority of survey respondents stated that more than one category of intermediaries operates within their regulatory framework. In some jurisdictions the distinction between agents and brokers is less relevant than the activity performed, as requirements are largely activity-based,[19] with supervisors taking a more thematic approach, notwithstanding the status of the intermediary. Activity could be determined according to lines of authority, by insurance sectors, by insurance product classes, or by type of customer (eg retail or wholesale). In other cases, supervisory requirements consider both intermediary status and activity.

[17] Conflicts of interest are discussed further in the IAIS *Issues Paper on Conduct of Business Risk and its Management*, see section 3.2.

[18] For more details, see section 4.2.3 of this paper.

[19] See ICP 18.08 and ICP 18.0.10.

Example: Australia

Following a thematic review, a report by the Australian Securities and Investments Commission (ASIC), *REP 471 The sale of life insurance through car dealers: Taking consumers for a ride*, identified policies being sold at comparatively high prices and to consumers who might not need life insurance. The review considered the likely driver of this conduct to be 'reverse competition' and conflicts of interest, where insurers compete on the incentives they pay to car dealers in commissions to buy access to distribution channels, rather than the price charged to the consumer. The review identified commissions of up to 50% of the premium are payable to intermediaries, and very low loss ratios (below 10%).

38. Different categories may be subject to different supervisory treatment. Categorisation can allow for the application of legal or regulatory requirements that can be more or less specific, or more or less stringent. It can, for instance, play a role in tailoring the requirements as regards duties towards customers or obligations related to the relationship with the insurer. Moreover, categorisation can promote a better understanding by supervisors of the market.

Example: United States

Insurance intermediaries are categorized as business entities or individuals. State insurance supervisors require the licensing of business entities, in part, to ensure the business entity name is not misleading, to review the qualifications of the officers and directors, and to identify a designated responsible intermediary who monitors the business entity's compliance with laws and regulations. Individuals are licensed because it is essential that individuals having direct contact with customers have a minimum level of knowledge and professional integrity to distribute insurance products. This ultimately promotes customer trust in the insurance distribution system and a strong and competitive marketplace.

Insurance intermediary licences are issued by the following lines of authority: Variable Life/Variable Annuity, Life, Accident & Health; Property, Casualty, and Personal Lines. The licensing by line of authority ensures a minimum level of knowledge for a particular type of insurance product.

39. Distinguishing between different types of intermediaries can also assist supervisors in applying a risk-based and proportionate approach to intermediary supervision, tailoring and targeting their supervisory activities in accordance with the conduct risks associated with different types of intermediaries and/or different activities.

Example: Québec, Canada

All intermediaries – individuals and firms – must hold a certificate or a licence to practice in one or more sectors or sector classes.

The certificate is delivered for the sector or the class sector in which the intermediary is authorized to act. The same can be said of firms to which an individual must be linked in order to carry out its activities.

Sectors and class sectors are: insurance of persons (accident and sickness insurance), group insurance of persons (group insurance plans and group annuity plans), damage insurance (personal-lines damage insurance and commercial-lines damage insurance) and financial planning.

This categorization is helpful in making certain that all intermediaries have the required skills and abilities to properly advise and sell insurance products to their clients. Through this regime, the qualifications, continuous education and responsibilities can be adapted to best suit the activities of a given sector or sector class and, as a consequence, allow greater supervisory efficiency by the Autorité des marchés financiers (AMF).

In essence, categorization allows the AMF to:

1) concentrate the greater part of its inspection efforts on high risk firms or high risk issues, due in part to its ex ante approach to compliance, which is generic but also class specific when required (eg mandatory exams and education, continuous education requirements, education efforts, mandatory registration, and categorization)

2) adapt, when needed, its supervisory matrix to reflect generic or class specific lacunae identified in the regulatory framework or during the course of a thematic or regular inspection.

3.3. Licensing and licensing requirements

40. Licensing requirements are the bedrock of intermediary supervision. ICP 18.1 states that "The supervisor ensures that insurance intermediaries are required to be licensed". [20] Licensing requirements create conditions with which intermediaries should comply at entry into the market, many of which are expected to be complied with on an ongoing basis. In order to be licensed, intermediaries have to fulfil certain requirements.[21]

41. In determining licencing categories, supervisors will usually do so in a manner that takes into account the nature of the intermediary and/or of the business to be intermediated (see discussion in paragraphs 26 to 39 above).

42. As noted in paragraph 30, there will generally be a considerably higher number of intermediaries operating in a jurisdiction than insurers, which can create challenges for supervisors. Licensing can therefore offer significant advantages to supervisors, by enabling them to have better knowledge of the market and its participants, with specific information on their status and activities. This can assist the supervisor in dealing with a large number of intermediaries, especially when insurers are only permitted to work with licensed intermediaries.

43. In some jurisdictions, the licensing of intermediaries may be performed by an institution other than the supervisor. Often, jurisdictions use an electronic licensing system and registers to ensure adequate record keeping and monitoring of significant numbers of intermediaries.

Examples:

France: Every insurance intermediary has to be registered by the ORIAS (*Organisme pour le registre des intermédiaires en assurance* – Insurance intermediaries' registration organization). To be registered, insurance intermediaries must meet some conditions: fulfil fit and proper requirements, be covered by professional liability insurance, have a financial guarantee. All these conditions are checked by the ORIAS at the intermediaries' registration.

In addition, insurers have an obligation to work only with registered intermediaries, or intermediaries that work in France on a freedom of services or freedom of establishment basis.

United States: State insurance supervisors, through the National Association of Insurance Commissioners and National Insurance Producer Registry maintain an electronic licensing system through which applications for insurance intermediation are processed. The licensing process is automated. This allows states to focus licensing resources on those applications which reflect potential problems with the professional integrity of the applicant.

As part of the electronic licensing process, state insurance supervisors have partnered with third party testing vendors to provide applicants with access to testing centres. Tests are also administered electronically, which eliminates the need for manual intervention.

Finally, a national database containing demographic and licensing information on all licensed intermediaries is maintained. In the event that a licensed intermediary is the subject of a regulatory action in one jurisdiction, all other jurisdictions in which the intermediary holds a licence are electronically notified.

44. Some jurisdictions may take alternative or simplified approaches to licensing of intermediaries acting on an ancillary basis.[22] For example, while ancillary intermediaries are required to be registered to enable supervisors to have knowledge about their activities, they may be exempted from the general regulatory framework applicable to intermediaries. This may be the case, especially where they sell products that can be considered simple or

[20] As noted in ICP 18.1.1, in some jurisdictions other terminology or processes, such as "authorisation" or "registration", are used in place of "licensing".

[21] Examples are included in ICP 18.1.5

[22] Where insurance is offered in connection with the main business activity which relates to non-insurance goods or services.

representing little risk for the customer, which may be determined, for instance, on the basis of the premium level or the nature of the product. Other jurisdictions have established alternative licensing and regulatory frameworks for individuals and businesses that only sell insurance on an ancillary basis. Such an approach takes into account the narrower and unique nature of the coverage of the framework while protecting consumers and incorporating appropriate safeguards. In such cases, they may apply minimum requirements, for instance, on knowledge and competence. Generally, intermediaries are not eligible for these alternative frameworks when the products that they sell are considered risky or have premiums above a minimum.

IAIS Members were asked whether a licence is required to sell insurance as ancillary business

- Several jurisdictions responded that insurance sold as ancillary business is exempted from licence/registration requirements if conditions are met.
- Other jurisdictions indicated that such business requires a licence or registration, which may be subject to differentiated requirements.
- In other jurisdictions a licence is not required where, for example:
  - insurance is complementary to the primary product or service being supplied. In that case, evidence of knowledge relating to the products offered will suffice.
  - a person whose business as an intermediary is incidental to some other business and is confined to the insurance of goods or services sold by that person, and the sale of insurance is part of a contract to provide goods or services.
  - an insurer sells products through non-licensed distributors that are ancillary sellers. In that case, the insurer must draft a distribution guide describing the product, specifying the nature of the warranty, and clearly explaining the exclusions. This guide must be given to the client prior to the insurance product transaction.
  - persons arrange insurance (where such insurance covers the risk of loss or damage to goods or services provided by that person) whose principal business is not that of insurance intermediation.

Example: <u>Australia</u>

In Australia, general insurance distributors may not need to hold a licence or be formally appointed as an intermediary to deal in general insurance on behalf of an insurer if they meet certain conditions. The insurer remains responsible for the relevant consumer protection measures required for the provision of the financial service by the intermediary, including providing proper disclosure and dispute resolution mechanisms.

45. As is the case for their intermediary supervision framework generally, supervisors should consider whether their licensing framework for existing business models is adapted to the new business models that are developed, for example in view of growth in digital commerce. As discussed in section 2.3, traditional regulatory and supervisory frameworks may need to adapt to the changing models for insurance distribution, including its licensing. Licensing requirements may be useful for specific business models, such as comparison websites, online business models, and the use of electronic tools.

3.4. Direct supervision

46. As stated in ICP 18.2, "the supervisor ensures that insurance intermediaries licensed in its jurisdiction are subject to ongoing supervisory review". This ongoing review may take various forms, including off-site monitoring, on-site inspections or other supervisory tools. Off-site monitoring may include supervisory reporting, analysis of complaints and other forms of information. The balance between off-site and on-site approaches will typically be influenced

by the number of intermediaries in the market and the nature, scale and complexity of their activities, as well as the supervisor's resources. The supervisor may also take these factors into account when deciding whether to adopt a mainly proactive approach to ongoing supervision, as opposed to a more reactive approach.[23] Ongoing supervisory review should assess ongoing adherence to formal licensing requirements, and may extend to review of broader aspects of intermediaries' conduct and treatment of customers.

3.4.1. Supervisory reporting

47. Several supervisors require intermediaries to submit – at least annually – reports on various aspects of their business. Required reports may include but are not limited to, financial reports, reports relating to the classes of insurance intermediated, types of products sold, business partners, remuneration, claims, complaints, and general compliance with licensing or other requirements. Such reports may be used directly to check compliance with applicable requirements and monitor market outcomes.

> Example: South Africa
>
> Financial Service Providers (FSPs) are required, inter alia, to submit compliance reports, financial statements and audit reports, where relevant, to the Registrar of FSPs and notify the Registrar of FSPs of any changes in key individuals and representatives. FSPs are required to maintain full and proper accounting records on a continual basis. FSPs who receive or hold client funds must submit to the Registrar a report compiled by the auditor that the money and assets held on behalf of clients were throughout the year kept separate from those of the business of the FSP, any instance of non-compliance identified in the course of the audit, and any other information required by the Registrar. FSPs other than sole traders must appoint a compliance officer. The higher the risk of a FSP, the more frequently compliance reports must be submitted to the Registrar. The compliance officers must also comply with fit and proper requirements.

48. Certain reports can help the supervisor understand the intermediation market for which it is responsible and, in some cases, identify practices (potentially good or bad) that it may want to look at in more detail during an on-site inspection or a thematic review.

49. In other cases, regular reporting is not required, but intermediaries are required to report any changes in relation to key information provided at the licensing stage. Where regular reporting is not required, other sources of information can provide useful input into the supervisory process (for example, see section 3.4.3).

50. Where supervisors require regular/ongoing reporting of compliance with licensing requirements they sometimes differentiate between different types of intermediaries, for example between agents and brokers. Some supervisors require only brokers to report to it, while others do not differentiate. A risk-based approach to reporting requirements may also be applied, with more detailed information required from larger intermediaries or intermediaries dealing in higher risk products, than that required from smaller intermediaries and/or intermediaries dealing in relatively simple products.

IAIS Members were asked to describe their reporting requirements for intermediaries

> - Some jurisdictions do not require regular reporting from intermediaries, but can require reporting on request.
> - Some jurisdictions require intermediaries to report any changes to the conditions when their licenses were issued.
> - Some jurisdictions require annual reporting of financial information, such as audited financial statements, external auditor's report, the amount of commission/fees received, as well as other issues, such as governance, compliance, and misconducts/complaint handling.

[23] For example only undertaking on-site visits or requesting information after receipt of complaints regarding the intermediary's conduct.

- Some jurisdictions do not require agents to report.

51. Finding the right balance in respect of reporting requirements can be a challenge to supervisors. It would be expected that reported information is used in supervision. Hence, reporting requirements should be adequate, but at the same time may need to take into account the size of the intermediary and the nature and complexity of its business.

3.4.2. Analysis of complaints

52. Some supervisors receive and analyse complaints on a regular basis. Complaints can be a valuable source of intelligence regarding conduct risk or market practices, particularly when looking at trends in complaints data or when comparing with benchmarks and expectations. Where increasing or high levels of complaints are found, this might be specific to an intermediary, related to a product sold by intermediaries, or related to market-wide behaviour or a pattern of conduct.

53. Information gathered for complaints analysis could include: the number of complaints, the products involved, stated reasons for complaints, resolution rates, and/or where litigation arises from complaints.

54. Ombudsman data can also be a valuable source of complaints-related information. In jurisdictions where customer complaints are primarily dealt with by an ombudsman and not by the supervisor, it is particularly important that supervisors have access to information about complaints received by the ombudsman and the issues identified and resolved.

55. Apart from customer complaints regarding intermediary business or behaviour, there might be disputes between an intermediary and an insurer. While not always having an impact on customers as such, this can be a relevant source of information for supervisors on market trends and conduct risks.

3.4.3. Thematic reviews and use of other forms of information

56. As highlighted by the IAIS *Application Paper on Approaches to Conduct of Business Supervision*,[24] in addition to complaints, supervisors may use other types or sources of information in addition to complaints. Examples could include data from or exchanges with consumer bodies, industry associations, industry or general media, and other conduct of business/customer protection regulatory or supervisory agencies. Further sources could be whistle-blowers, court proceedings, or data on general economic and environmental factors impacting on customer behaviour and expectations.

57. Some supervisors also use mystery shopping to identify potential consumer detriment and help the supervisor understand the way in which the intermediary actually conducts its business with customers.

58. Monitoring advertising can also be an important source of information, allowing supervisors to detect violation of conduct of business rules, as well as assisting in identifying changes in business practices and the development of new products.

59. Market monitoring and thematic reviews by the supervisor can provide complementary information to that received as a result of supervisory reporting requirements. It can help to inform the supervisor on intermediation practices and activity. It can also contribute to a better understanding of the market and market trends and, using a forward-looking approach, can help to detect emerging conduct risks at an early stage.

[24] Available at: http://iaisweb.org/page/supervisory-material/application-papers. See section 3.4.

Example: Australia

ASIC has undertaken a range of thematic reviews on insurance conduct issues, including on the sale of insurance by car dealers (REP 471), the sale of home insurance (REP 415), and the sale of funeral insurance (REP 454). Thematic reviews have enabled ASIC to measure market outcomes, including through identification of good and poor practice, with recommendations made to insurers and intermediaries on how conduct standards can be raised. Follow-up thematic reviews have enabled ASIC to measure improvements in industry practice as a result of these recommendations being implemented by insurers and intermediaries.

3.4.4. On-site inspection

60. Some supervisors conduct on-site inspections of intermediaries. Where there are significant numbers of intermediaries to supervise, the extent to which on-site inspections are carried out often follows a risk-based approach. In general this means that on-site inspections, or more frequent on-site inspections, take place where there is some evidence of increased risk; for example where there may be an increased likelihood of conflicts of interest, or where the nature of the business intermediated is more complex. Conducting random on-site inspections, especially in markets with significant numbers of intermediaries, may not only help supervisors to assess compliance, but may also serve as a general compliance incentive for intermediaries. The size and vulnerability of the intermediary's customer base may also be taken into account.

61. On-site inspections can be useful for supervisors to follow up on potential risks that have been identified as part of off-site monitoring.

Example: Québec, Canada

A risk matrix is elaborated according to the information required by the supervisor and provided by the intermediaries. This permits an assessment of whether they comply with the requirements and if there are weaknesses or information to be verified by an on-site inspection. The regulator can also have an idea of the conduct of business of each intermediary and see their evolution. On-site inspections are not automatic but related to the results of the risk matrix.

3.5. Indirect supervision

62. While direct and indirect supervision are described in separate subsections in this paper, supervisory approaches often involve a combination of the two.

3.5.1. Through insurer supervision[25]

63. Sometimes intermediaries are supervised indirectly. Where this is the case, the insurer is responsible for monitoring the conduct of intermediaries and reporting to the supervisor. An indirect approach may be more appropriate for the agent model than the broker model. Under this approach, the supervisor reviews compliance by insurers in supervising intermediaries through its on-site inspection and/or off-site monitoring of the insurer. Where supervision of insurers and intermediaries is allocated to different authorities, or different divisions within an authority, coordination between the intermediary supervisor and the insurance supervisor is particularly important for these indirect supervision models.

Examples:

Germany: The federal states are responsible for the supervision of intermediaries, which is usually facilitated by the chambers of industry and commerce.

Tied intermediaries are supervised by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) indirectly via the supervision of insurers. As the distribution of insurance products via intermediaries is associated with considerable risks for the insurers, control and management of these risks have vital importance in the risk management of the

[25] See ICP 18.2.9-14

insurer. Therefore BaFin asks insurers to require suitable control instruments that facilitate early detection. Otherwise insurers and policyholders may not be adequately protected against damage. The control instruments may depend on the individual circumstances and the type of insurance business conducted.

Where intermediaries need a licence, insurers shall not engage with them unless they have been authorized by the competent authority pursuant to the laws of the respective federal state. Insurers must verify the presence of such authorisation by inspecting the register of intermediaries before commencing any relationship. Where insurers have doubts as to whether the intermediary fulfils the requirements under commercial law they must notify the supervisor responsible for the intermediary accordingly.

United States: An insurer is generally required to appoint agents who represent the insurer. This requires the insurer to conduct their due diligence on the integrity and professional knowledge of the agent. In addition, the record of the appointment is filed with the state insurance regulator.

India: Insurers in India are required to conduct an annual inspection of the corporate agents covering various aspects of business, such as solicitation only through specified licensed persons, AML training and systems, record maintenance, and file the report with the supervisory authority.

64. Supervisors can also use their supervision of insurers to gather information and, to some extent, monitor intermediaries' activities.

65. Where insurers actively monitor consumer complaints and sales patterns, this may help to identify possible conduct issues not only with specific intermediaries but potentially also market-wide misconduct.

Example: Slovenia

The Agencija za zavarovalni nadzor (AZN) conducts on-site reviews to understand how insurers manage risks associated with their sales channels (including how insurers ascertain the suitability of potential new intermediaries and how they check their performance and claims results and identify basic early warning indicators), and to understand their complaints process and the nature of complaints made to each insurer. AZN checks cancellations of life insurance policies by reference to the specific sales channel/intermediary, and also checks commission flows to intermediaries. A risk-based approach is then taken to on-site supervision.

3.5.2. Through self-regulatory organisations

66. Self-regulatory organisations (SROs) can exercise some degree of oversight and contribute to the supervision of intermediaries.[26] In jurisdictions where SROs exist and have appropriate powers and resources, they are seen as a way to supervise a high number of participants in the market and to help supervisors concentrate on other monitoring tasks.

Example: United Kingdom

The United Kingdom's Solicitors Regulation Authority's (SRA) is a designated professional body with the power to regulate and supervise certain activities of its members which would otherwise be the responsibility of the Financial Conduct Authority (FCA). The terms on which these oversight activities are undertaken are governed by a Memorandum of Understanding between the SRA and the FCA in respect of SRA members that qualify as exempt professional firms, carry out exempt regulated activities, or are authorised professional firms. The Memorandum of Understanding covers the respective duties and functions of the FCA and SRA, reporting by the SRA to the FCA in respect of its supervisory functions, and cooperation and information exchange between the two.

67. Supervisors should have oversight of these SROs and their activities, in view of their overall responsibility and may set standards regarding the oversight responsibilities of the SRO, including to ensure a minimum level of independence. Indeed, bearing in mind that SROs' oversight is over their own members, and hence could be seen to involve potential conflicts of interest, their approach should demonstrate appropriate objectivity. To be able to use work of SROs as part of the supervisory framework, supervisors should confirm that SROs'

[26] See ICP 18.2.15-17

roles and requirements are consistent with supervisory standards and guidance. In addition, they may also consider how SROs are accountable to the supervisor and the public. Further, the respective responsibilities of supervisor and SRO should be clear to avoid confusion or unnecessary duplication.

68. In exercising a certain degree of oversight, SROs can have a role in resolving complaints. They can also have educational responsibilities such as the organisation of seminars that contribute to intermediaries' maintaining a high level of knowledge. Where such a role is undertaken more as a preventive measure than one of supervision, it can have significant positive effects on the conduct of intermediaries.

3.6. Supervisory measures

69. The supervisor should be able to take measures against an insurance intermediary (whether licensed as an entity or an individual).[27] Supervisory measures could be triggered by various matters, including:

- failure to meet ongoing licensing requirements;
- activity or behaviour that puts consumers at risk;
- failure to manage conflicts of interest;
- shortcomings in competence or integrity;
- concerns over business continuity; or
- in response to governance or internal control failings such as inadequate policies, procedures, file keeping or documentation, or insufficient controls over the handling of confidential data.[28]

70. Measures may be preventive and/or corrective and the nature of such measures can vary, including:

- warnings;
- improvements to policies and procedures;
- redress to customers;
- restrictions on particular practices or individuals;
- licence withdrawal;
- injunctions; and
- financial sanctions.

71. The supervisory action taken should be proportionate as well as effective; intermediaries should have the right to appeal enforcement decisions. Sanctions can act as a deterrent, for example, where minimum levels apply to financial sanctions, or where sanctions imposed are published.

72. The supervisor should also be able to take measures against insurance intermediaries operating without a licence. Early detection of intermediaries operating without a licence will help to mitigate risks, particularly to consumers.

3.7. Resourcing and supervisory capacity

73. The legal authority with respect to intermediary supervision needs to be clear and well understood by supervisory staff and market participants. Staff need to be properly trained and

[27] Or against an insurer in the case of its direct sales staff.

[28] See also ICP 18.7 and related guidance.

have appropriate levels of experience and seniority. As the supervision of intermediaries focuses on customer fair treatment, it requires appropriate knowledge, skills and abilities, including a strong understanding of:

- insurance and intermediary law and regulations;
- general consumer protection practices;
- insurance and intermediary business models, products and practices;
- best practices and risks related to fair treatment of consumers.

74. Resourcing the intermediary supervisory function will depend on the approach taken. For example, a “direct” approach will require supervisory staff who have – in addition to legal and regulatory knowledge – appropriate insurance industry experience and product and business model knowledge, as well as economic and market analysis skills to identify emerging industry-wide risks. An “indirect” approach may focus more on the effectiveness of insurers or SROs in undertaking their oversight role, and the market analysis.

4. Supervisory requirements and approaches that promote good conduct of business

75. As reflected in ICP 19, the primary objective of conduct of business supervision is to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. In the case of intermediary supervision, supervisors should therefore consider the role that intermediaries may play in the post-sale stages of the product lifecycle (see discussion in section 4.6).

76. Other objectives may also be taken into account, such as:

- promoting trust and confidence in insurance markets;
- promoting public awareness of matters relating to insurance products and services to help consumers exercise informed choice; facilitating the efficient operation of insurance markets;
- ensuring that products sold meet customers' needs; and
- avoiding the sale of products that are harmful to customers.

77. Insurance intermediation is an essential function in the distribution of insurance products and services, but may not always rank highly among customer priorities. It involves the provision of useful information and inquiries designed to identify the financial needs/risks of the customer and the skilful presentation of solutions through insurance products and services.

4.1. Minimum eligibility requirements

78. Insurance intermediation requires diverse skills and competences including insurance product knowledge and experience, as well as ethical behaviour and integrity. The supervisor should take these into consideration when framing eligibility requirements for intermediaries.

79. To enter the market, and continue to operate, insurance intermediaries should meet a set of minimum standards or requirements. ICP 18.3 states that "the supervisor requires insurance intermediaries to possess appropriate levels of professional knowledge and experience, integrity and competence". This represents a safety net for the customer to secure a minimum level of protection.

80. The requirements to meet these obligations may differ from one jurisdiction to another. Also, it is common within single jurisdictions for requirements to vary depending on the type of intermediary (eg status, type of business intermediated, whether the intermediary is a natural or legal person). There may be variations[29] in terms of the number of requirements to be fulfilled as well as in terms of depth of these requirements. In some cases, employees of intermediaries who solicit business also have to fulfil certain conditions. Moreover, it is common for Senior Management and Key Persons in Control Functions to be subject to higher standards.

4.1.1. Professional knowledge, experience and competence

81. Setting standards with regard to professional knowledge and experience seeks to achieve a minimum level of competence.

82. In almost all jurisdictions, intermediaries are required to demonstrate their competence on the basis of their knowledge and experience. This can be done through various means, either complementary or alternative. Supervisors can consider:

- Relevant education and degrees. Intermediaries often have to have a minimum level of school education. Depending on the nature and complexity of the products they

[29] See ICP 18.3.3

intermediate or the services they offer, they may be required to hold specified degrees or other formal qualifications. Supervisors will expect the education or qualifications obtained to be relevant.

- Professional qualifications (including in some cases examinations set by the supervisor or on its behalf). In cases where qualifications are "in-house" (ie set up and administered by the intermediary firm), it can be difficult for the supervisor to verify their quality.
- Continuous training and/or professional development requirements. Both the content and the minimum amount of time spent on such professional development are relevant. Also, the conditions of how these requirements are undertaken can be a factor: for example, face-to-face training may be regarded as likely to be more effective than on-line or correspondence courses.
- Professional or other work-related experience in a relevant field. Checking intermediaries' professional experience can be challenging for supervisors. Confirmation of employment experience can be useful; however the type of experience gained (eg general insurance or product-specific experience will be relevant) is not always easy for the supervisor to assess. For this reason, assessing professional experience is often used primarily where other, more objective measures, such as evidence of professional qualifications, are not available.
- Requiring operation under supervision or on an internship/apprentice type basis in a relevant field for a specified period.

83. Obtaining and validating actual evidence of competence, and assessing its relevance and appropriateness, can be a challenge to supervisors. Information that supervisors could refer to in this regard might include: continuous professional development (CPD) records; evidence of performance appraisals; references, including work experience, from former employees; qualifications and their relevance; and evidence of on-the-job and other internal training.

Example: India

Eligibility requirements are often set out based on type of intermediary ie whether agent or a broker. Differentiation is also made based on whether the agent is an individual or a legal person. In the case of institutional agents and brokers, apart from a principal officer who should be a well-qualified and experienced insurance professional, all the designated employees who are employed to solicit business are also required to undergo training of a requisite number of hours on a prescribed syllabus, and pass the test in order to be licensed.

In the case of individual agents, it is standard practice to prescribe:

- Minimum Educational Qualification (eg Pre university course);
- Fixed number of hours (eg 50-100 hours) of training in the syllabus prescribed;
- Passing a test conducted by a professional body of Insurance Education specified; and
- Training and/or test requirements periodically thereafter for renewal of licence or continuous professional development.

In the case of brokers, the Principal Officer is expected to:

- Be a graduate with an Insurance Professional Qualification;
- Undergo theoretical and practical training of a certain number of hours, eg 100 in the prescribed syllabus; and
- Pass an examination conducted by a professional body specified.

In addition to the Principal Officer, any employee of the broker responsible for soliciting and procuring business on its behalf also has to fulfil training and pass an examination prescribed.

The knowledge and experience requirements can vary depending on the type of licence and lines of business the intermediary is authorised for or the complexity of products authorised for. For example, to authorise an agent for an additional line of business such as health insurance, an additional 25 hours training on health insurance and a certification may be prescribed.

84. Intermediaries should also keep their knowledge up to date and stay aware of changes in the market segment they serve including new, emerging and developing products. While it is generally not a requirement to understand all of the products offered in the market, intermediaries should at least have a thorough knowledge of the products they intermediate and any relevant differences between them.

85. A challenge for supervisors is how to verify that competence requirements are being maintained. Approaches to consider include requiring intermediaries (or some types of intermediaries) to participate in CPD programmes run by relevant professional bodies; requiring them to undergo periodic "refresher" training on relevant product lines; requiring their management (or the insurer in the case of agents) to certify their ongoing competence from time to time; and requiring insurers to ensure that intermediaries are accredited on their products (including new products as they are launched) before they are permitted to sell them.

Example: Québec, Canada

One of the supervisory approaches to maintain competence is the statutory requirement for a specific number of continuous education hours per period in mandatory fields such as compliance, general business skills and specialties. The oversight will be done through a mandatory declaration system. Failure to obtain the required continuous education hours and/or to declare them within the required period of time will trigger a suspension of the licence until those hours are completed.

4.1.2. Integrity

86. As referred to in ICP 18.3.6, integrity relates to qualities of individuals such as being honest, trustworthy and open, being reliable, dependable and respectful not taking unfair advantage, and not accepting or offering gifts where this might imply an improper obligation.

87. The supervisor may require that individuals acting as intermediaries are subject either to internal policies and procedures, or to the ethical standards of professional bodies that require integrity. Sometimes these requirements are set by regulation or law.

Example: European Union

The European Union Insurance Distribution Directive provides that, when carrying out insurance mediation with or for customers, an insurance intermediary acts honestly, fairly and professionally in accordance with the best interests of its customers.

88. Supervisors may also prescribe a code of conduct for intermediaries to adhere to, which may describe various aspects of dealings between insurance intermediaries and their customers. Codes may also be drafted by, for example, professional associations as a self-regulatory (non-mandatory) initiative or may take the form of binding regulatory requirements.

89. Supervisors may require intermediaries to have systems and procedures in place to carry out background checks on their employees or representatives, both at the entry stage and for ongoing requirements. Supervisors may verify through the supervisory process that intermediaries follow these systems and procedures, and review them regularly to keep them up to date.

90. Supervisors may consider factors that display a lack of integrity and thereby disqualify an intermediary from engaging in regulated activities, for example:

- where they have been found guilty of crimes of dishonesty by a court of competent jurisdiction. Examples of such crimes would be theft or other misappropriation, breach of trust, or forgery, and might include committing and abetting the commission of such an offence, as well as attempting or conspiring to do so;

- where they have been disqualified from other positions of trust (for example disqualified from acting as a company director or trustee); or
- where such proceedings are pending (subject to jurisdictional laws).

91. Generally, both individual intermediaries and intermediary firms' Senior Management and Key Persons in Control Functions should fulfil this integrity requirement. Employees of intermediaries are often also subject to such requirements if their role involves soliciting, negotiating or selling insurance.

4.1.3. The role of professional standards

92. The professional standards of SROs and professional bodies can be useful in helping intermediaries to meet the supervisory requirements related to professional knowledge, experience, integrity and competence.[30] Where they apply and support the supervisory objectives, supervisors can use these as a tool to promote compliance with the regulatory requirements in a consistent and uniform way. In some cases, membership in these bodies may be a requirement for certain types of intermediaries.

93. Professional bodies and SROs can promote professional norms and standards in insurance intermediation with which their members should comply. Such standards may include areas such as:

- professional ethics and integrity;
- fair treatment of customers;
- service standards;
- acting with the customer's best interests in mind;
- complaints handling;
- customer data confidentiality; and
- non-interference in the business introduced by other agents.

> Examples:
>
> <u>Namibia</u>: Intermediaries are required to adhere to a code of conduct issued by a self-regulatory organization.
>
> <u>Hong Kong, China</u>: SROs issue guidelines about how to advise policyholders in an appropriate manner.
>
> <u>Québec, Canada</u>: The Distribution Act established the Chambre de la sécurité financière and the Chambre de l'assurance de dommages. Chambers shall ensure the protection of the public by maintaining discipline among and supervising the continuous education and ethics of their members. Except in the case of financial planners, the chambers determine the rules governing the professional development of their members. Furthermore, a discipline committee has been established in each of the chambers. The committee handles all complaints filed in respect of a representative for breaches of the rules of professional conduct. The provisions governing the chambers are based on codes of ethics established by regulations.

94. Failure to comply with an industry code or other self-regulatory instrument may result in the SRO (or relevant compliance body) cancelling membership of an entity or individual, or taking other disciplinary action.

95. There are different methods of helping intermediaries meet the supervisory requirements by elaborating the professional norms and standards. Some professional bodies

[30] See ICP 18.3.13-15

and SROs use clear, written policies that their members are expected to comply with, while others use a more principles-based approach such as codes of conduct. The level of detail can and does differ.

96. These bodies can also play a role in providing intermediaries with resources that can help them to build and maintain the professional competences they need (over and above technical qualifications), in areas such as financial planning and advice, risk analysis, and industry and regulatory developments.

4.2. Organisational requirements that promote the fair treatment of customers[31]

4.2.1. Corporate governance and internal controls

97. According to ICP 18.4, "the supervisor requires that insurance intermediaries apply appropriate corporate governance". Whilst good corporate governance is no guarantee of fair customer outcomes, it is a fundamental element in promoting the fair treatment of customers.

98. As acknowledged in ICP 18.4.1, requirements on corporate governance may vary depending on the nature and scale of the intermediary and the complexity of its business (as is the case for many of the requirements discussed in this paper).

99. Due to the small size of some market participants, it may not be appropriate to apply corporate governance and internal control requirements to such intermediaries in the same manner as to larger entities. Nevertheless, the supervisor should be satisfied that a minimum standard of governance is achieved and that there are no unacceptable risks. The overriding objective should be that consumers are appropriately protected.

- **Corporate governance**

100. Corporate governance is concerned with the framework under which an entity is managed, including the roles and responsibilities of those accountable for its management. It includes the culture, business objectives and strategies, and the effect of these on the way in which business is conducted and the way in which customers are treated. Good corporate governance of intermediaries should be based on a culture that supports the fair treatment of customers.[32]

101. Good corporate governance should be embedded in all the policies and processes that are in place within the intermediary and that frame its conduct of business. The conduct of business requirements in ICP 19 support the notion of good corporate governance, and the contribution of appropriate conduct of business standards towards good corporate governance by intermediaries is specifically mentioned in ICP 18.4.2.

102. From an organisational perspective, the role of the Board (or equivalent senior leadership body) is of paramount importance in embedding a culture of fair treatment of customers into intermediary policies and processes, from the top down.

103. Good governance may be promoted by the supervisor, as well as by other authorities and organisations publishing guidance, for example through a Code of Practice that sets out expectations to insurance intermediaries on their obligations in respect of governance-related matters.

[31] See ICP 18 as well as ICP 19.2

[32] ICP 7 covers insurers' corporate governance. Although this ICP is not directly applicable to intermediaries, it may be a useful source of information for intermediary supervisors.

- **Risk management and internal controls**

104. Internal controls are a set of processes, policies and activities governing the intermediary's organisational and operational structure including reporting and the control function and are an element of good governance.

105. Intermediaries' internal control systems require adequate human resources, and may cover matters including:

- standards for conduct of business and compliance with these and other relevant legislation;
- controls over outsourced functions; and
- the maintenance of adequate files and records (which should be maintained and should available for inspection).

106. Before issuing a licence, the supervisor is likely to require information regarding policies, procedures and controls in key areas.[33]

107. The supervisor may also require that intermediaries undertake a regular assessment of the risks to which they are exposed, and to which they may expose their customers, including consideration of new and emerging risks, and how to mitigate and manage such risks.

- **Protection of confidential information**

108. Intermediaries hold personal information on their customers. Customers expect confidential information to be treated as such. For this reason supervisors require intermediaries to have internal controls for the protection of private information on customers.[34] Safeguarding such information is crucial in maintaining trust in the insurance industry.

109. Where appropriate, supervisors need to be able to communicate with the relevant authority responsible for data security.

110. The supervisor should require that the policies, procedures and internal controls cover IT security and the protection of confidential information, which include:

- assessing the risks associated with any major breaches in security;
- mitigating their impacts; and
- reporting, in a timely manner, security breaches to affected customers and supervisors.

111. As is the case with insurers, good corporate governance by intermediaries also implies that they maintain adequate control over any outsources activities. Amongst other things, where intermediaries outsource processes, sufficient safeguards are needed to prevent the misuse or inappropriate communication of any personal information they hold.

4.2.2. Conflicts of interest

112. As discussed in the IAIS *Issues Paper on Conduct of Business Risk and its Management*, conflicts of interest can create barriers to good conduct, particularly where the insurance seller is in a stronger position than the buyer, for example with respect to information asymmetries. They can arise at the beginning of the contractual relationship, during the pre-contractual phase and/or during the life of the product.

[33] See ICP 18.1.5.

[34] See ICP 19.12.

Example: Australia

ASIC's report, entitled *REP 470 Buying add-on insurance in car yards: Why it can be hard to say no*, identified information asymmetries at the beginning of the contractual relationship with consumers and the car salesmen that sell add-on insurance in car dealerships. This led to consumers being unaware of the cost of, or cover or value provided by, add-on insurance products and most purchases were made solely on the basis of information provided in the car dealership. The review also identified examples of pressure selling tactics, driven by conflicts of interest.

113. As intermediaries interact with both insurers and customers, they may be exposed to conflicts of interests. Conflicts of interests generally involve situations where the interests of the intermediary conflict with the interests of a customer, and can be influenced by the relationship between the intermediary and the insurer whose products they sell. Conflicts of interest can arise from financial incentives (eg through certain compensation structures) and non-financial incentives. Potential sources of conflicts of interest are discussed further in the above-mentioned Issues Paper.

114. In particular, where an intermediary has a role in core insurance functions, such as the design and pricing of products, underwriting the risk or assessing claims, the supervisor should be concerned that the relationship between the insurer and intermediary does not result in the unfair treatment of customers (eg where the product is unreasonably highly priced and/or not in customers' interests).

115. In assessing conflicts of interest, the supervisor may wish to refer to the whole distribution chain, including the respective insurer, to build up a complete picture. This may help to identify where pressures that could give rise to potential conflicts of interest may lie.

- **Managing conflicts of interests through procedures**

116. The supervisor should require insurance intermediaries to take reasonable steps to identify, avoid or mitigate conflicts of interests through appropriate policies and procedures[35].

Example: Australia

In October 2014, ASIC published a report of a thematic review into intermediaries who give advice to consumers about life insurance, entitled *REP 413 Review of retail life insurance advice*. The review found that conflicts of interests had a clear impact on the quality of advice provided to consumers as well as intermediaries' compliance standards. The review found life insurance policies lapsing at high rates, in years two and three of the policies, and found a correlation between high lapse rates and high upfront commission models. The review found that one-third of the advice files reviewed did not comply with Australian quality-of-advice laws and that the way an adviser was paid (eg under an upfront commission model compared to a hybrid, level or no commission model) had a statistically significant bearing on the likelihood of their client receiving advice that did not comply with the law.

117. The supervisor should be satisfied that intermediaries have robust procedures in place to identify and manage conflicts of interests.

Examples:

European Union: The European Union's Insurance Distribution Directive cover the distribution of not only non-life and life insurance products, reinsurance products, but also insurance-based investment products (IBIPs). One of its main objectives is to strengthen consumer protection. It includes new requirements with regards to conflicts of interests. For all products, insurance distributors will have to act honestly, fairly and professionally in accordance with the best interests of their customers. Before the conclusion of the contract, consumers will be provided with clear information about the professional status of the person selling the insurance product and about the nature of remuneration which he will receive. For the insurance-based investment products, the Directive contains additional requirements: Intermediaries and undertakings have to take (proportionate) arrangements to prevent conflicts of interest from adversely affecting the interests of their customers and must take steps to identify conflicts of interest.

[35] See ICP 19.7

If the arrangements taken are insufficient to ensure that the risk of damage will be prevented, there is a requirement for disclosure of the general nature or sources of conflicts of interest to be made in good time before the conclusion of the contract.

South Africa: The General Code contains both principles-based requirements regarding the avoidance, management and mitigation of conflicts, as well as rules-based requirements in relation to maintaining a conflict of interests management policy; conflicts related to disclosure obligations; and prohibitions on specific types of conflicted remuneration, practices and business models.

118. In addition to intermediary policies and procedures being available to the supervisor, the supervisor may encourage intermediaries to make relevant policies and procedures publicly available as good practice, in particular those in respect of conflicts of interest and complaints handling and dispute resolution.

- **Managing conflicts of interest through disclosure**

119. Appropriate disclosure can help in managing conflicts of interest where it empowers consumers to identify and challenge or avoid potentially poor advice or selling that may arise through the conflict of interest.

120. Before entering into a contract, an intermediary should disclose certain information to the customer, such as information regarding their status, business partners, financial links with insurers, the range of insurance products with which they deal, and basis of remuneration (including inducements).[36] This can provide an indication of potential conflicts of interests, enabling the customer to determine whether the intermediary's advice may be influenced by his or her own financial interests.

Example: France

Insurance intermediaries have to disclose specific information to their customers during the pre-contractual phase. They are required to disclose the financial links they have with insurers or credit institutions, that means whether the intermediary has a holding representing more than 10% of voting rights or 10% of the capital in such an entity (or the other way round). Insurance intermediaries also have to give information as regards their level of independence. To do so, the intermediary gives details to its customers on whether it is working under an exclusivity agreement with an insurer or credit institution. They also have to give information to the customer as to whether the insurers they work with are limited in number, and to give a list of their business partners. Moreover, the intermediary must also disclose whether they will analyse a sufficiently large number of contracts available on the market to provide a fair analysis.

121. Information on the product charging structure[37] can be particularly important in respect of investment-related products. For example, fees and costs can undermine the total funds invested and thus affect the return on investment. The timing of such disclosure can have an impact on the customer's decision, and for this reason many supervisors require information on remuneration – and the impact of this on product charges – to be disclosed at the pre-contractual stage, especially regarding insurance products with an investment element.

122. Managing conflicts of interest through disclosure has limitations as evidenced by research.[38] Relying on disclosure could be seen to place unreasonable onus on the customer

[36] ICP 18.5 requires information on the basis on which intermediaries are remunerated to be disclosed where a potential conflict of interest exists.

[37] See ICP 18.5.12-18.

[38] For example, a paper by the UK's Financial Conduct Authority: *Applying behavioural economics at the Financial Conduct Authority* (April 2013) highlights the influence of behavioural biases in limiting the effectiveness of disclosure. The paper observes, inter alia, that "behavioural biases can affect how consumers assimilate, understand and act on the new information, often making the disclosures ineffective." A paper by Cain, Loewenstein and Moore entitled *When Sunlight Fails to Disinfect: Understanding the Perverse Effects of Disclosing Conflicts of Interest*, published in the Journal of Consumer Research (2011), argues that disclosure of conflicts of interest can

to identify the conflict, understand the way in which it may disadvantage them, and negotiate with the intermediary to avoid that disadvantage. In cases where the supervisor has concerns about the ability of disclosure to deal adequately with conflicts of interest, the supervisor may consider implementing other measures to manage such conflicts.

- **Approaches to remuneration**

123. Jurisdictions have implemented a range of requirements in respect of intermediary remuneration. In some cases, requirements may also apply to the remuneration of staff not directly involved in intermediation.[39]

124. Conflicts of interest that may arise through compensation structures/remuneration can be managed – particularly by larger intermediaries – through the intermediary adopting a remuneration policy. Such a policy would have the objective of aligning compensation structures and incentives to support the fair treatment of customers. For example, such a policy could specify an appropriate ratio between fixed and variable remuneration, or apply limits that avoid disproportionate bonuses or incentives.

Example: Netherlands
There is a general restriction on variable remuneration. This may not exceed annual fixed remuneration by more than 20%. In addition, each firm is required to have a written policy on remuneration that highlights potential conflicts of interests.

125. The use by intermediaries (or insurers in the case of agents) of qualitative criteria (such as the degree of compliance with relevant conduct of business rules, adequacy of the processes used to ensure suitable advice, and customer complaint information) and not only quantitative criteria (such as sales volumes) to evaluate the performance of individuals may be a means to help remuneration and reward strategies contribute to fair customer outcomes.

126. The timing of the payment of remuneration could also be used to help manage conflicts of interest. By postponing or staggering payment, entities could limit inappropriate short-term and immediate incentives in order to align intermediary and entity interests with those of the customer.

Example: Netherlands
For non-life products, commissions need to be spread out for a longer period of time to align the interests of the client with the interests of the intermediary (creating a long-term relationship instead of hit-and-run opportunities).

127. Some jurisdictions place restrictions on remuneration such as by prohibiting the payment or receipt of commission on the sale of life insurance and/or investment-related products in favour of a fee-based approach.

be counterproductive when it leads advisors to give more-biased advice that is not sufficiently discounted by advice recipients.

[39] See *Issues Paper on Conduct of Business Risk and its Management*, paragraph 71.

Example: Netherlands

Beside the obligatory transparency regarding distribution costs and remuneration, a ban on commissions was introduced as of 1 January 2013. The reason for the introduction of the ban was to align the interest of the intermediary with the interest of the client. The ban is applicable for all intermediaries, including sales agents from insurers and banks that are selling non-MiFID[40] financial services excluding non-life insurance. During the transition period, many financial services providers changed their business model to a fee-based approach, charging either an hourly rate or a fixed fee. Additional legislation was introduced to ensure that the cost of the advice is reasonable. As the ban only applied to new products sold after 1 January 1 2013, it had a limited effect on the remuneration received by financial services providers for products sold prior to that date, most notably insurance investment products with a long duration.

128. Several other jurisdictions have put in place remuneration caps or a ban on commission. In some cases, the cap on commission applies only to compulsory insurance; in some other cases, the commission level or cap on remuneration is determined by category of product and percent of premiums.

129. Additional approaches in respect of compensation structures identified by different IAIS Members include:

- reducing commission by the fee for advice in situations where an advice fee is charged;
- requiring commission for a life policy to be paid over a set period to align payment with the policy period;
- using a balanced scorecard framework to take into account non-sales key performance indicators in remuneration structures; and
- clawback provisions in which the intermediary is required to return a proportionate part of the commission if the customer does not retain the product for a certain period.

130. Some jurisdictions link remuneration to costs incurred by intermediaries or parameters that indicate quality of services.

Examples:

Poland: the Komisja Nadzoru Finansowego has issued guidelines according to which the remuneration that an insurance agent receives when offering insurance products should be determined taking into account the costs incurred. Moreover, the insurer should ensure that the insurance agent's commission does not undermine customer confidence in the financial market. Following the issuance of these guidelines a formal provision of law came into force and imposed an obligation on insurance undertakings to distribute intermediary remuneration over the whole period of insurance, which restricts insurance undertakings and intermediaries even more than the guidelines.

Québec, Canada: the Code of ethics of damage insurance representatives provides that "where he is not paid exclusively on a percentage basis, a damage insurance representative must charge and accept remuneration or compensation that is fair and reasonable given the services rendered. In particular, he must take into account the following factors in determining his remuneration or compensation: (1) his experience; (2) the time devoted to the matter; (3) the difficulty of the problem submitted; (4) the importance of the matter; (5) the responsibility assumed; (6) the provision of unusual services or services requiring exceptional competence or speed; (7) the result obtained."

131. In placing restrictions on remuneration, consideration should be given to potential negative consequences to consumers that may – at least initially – result, such as restricting access to advice and other services provided by intermediaries.

132. Some jurisdictions have set supervisory requirements under which intermediaries disclose remuneration to customers, for the reasons described in paragraphs 120 and 121 of

[40] European Union's Markets in Financial Instruments Directive.

the paper. Such disclosure may include the amount of remuneration in terms of absolute value and/or in terms of percentage of the premium. In some cases disclosure is required under certain conditions, for example where the insurance premium exceeds a specified amount or where a customer makes a request for disclosure.

Examples:

United States: Section 18 of the NAIC Producer Licensing Model Act provides for rules on compensation disclosure:

A. (1) Where any insurance producer or any affiliate of the producer receives any compensation from the customer for the placement of insurance or represents the customer with respect to that placement, neither that producer nor the affiliate shall accept or receive any compensation from an insurer or other third party for that placement of insurance unless the producer has, prior to the customer's purchase of insurance:

a. Obtained the customer's documented acknowledgment that such compensation will be received by the producer or affiliate; and
b. Disclosed the amount of compensation from the insurer or other third party for that placement. If the amount of compensation is not known at the time of disclosure, the producer shall disclose the specific method for calculating the compensation and, if possible, a reasonable estimate of the amount.

(2) Paragraph (1) shall not apply to an insurance producer who:

a. Does not receive compensation from the customer for the placement of insurance; and
b. In connection with that placement of insurance represents an insurer that has appointed the producer; and
c. Discloses to the customer prior to the purchase of insurance:

i) That the insurance producer will receive compensation from an insurer in connection with that placement; or

ii) That, in connection with that placement of insurance, the insurance producer represents the insurer and that the producer may provide services to the customer for the insurer.

Hong Kong, China: A potential conflict of interests exists when brokers, who act on behalf of the policyholders, accept remuneration from insurers. The Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association have adopted a uniform disclosure standard which requires insurance brokers to disclose to their clients that they are remunerated for their services by the commissions paid by insurers, and to provide remuneration details upon a clients' request. Brokers are required to obtain clients' implied consent to their receipt of remuneration before they can proceed with the transaction. When asked about the extent of remuneration, brokers should disclose that information in terms of the maximum percentage of the premium paid (or to be paid) for the policy concerned or as a maximum dollar amount. Where the remuneration is higher than that customarily paid for the particular class of insurance, additional measures for disclosure and express consent may be required.

- **Other measures to manage conflicts of interest**

133. In some jurisdictions, certain types of financial interest that may generate conflicts of interest are prohibited. Such interests may include financial links with other entities, non-cash incentives from insurers or their associates, the payment by an intermediary of a referral fee to secure business, or commission sharing or other payments/gifts to the customer.

Examples:

India: Section 41 of the Insurance Act expressly prohibits inducements to a customer for taking out a policy or a rebate of commission, except where the rebate is allowed in accordance with approved premium tables. Any person not complying shall be punishable with a fine of up to one million rupees.

Québec, Canada: P&C insurance brokers may not have more than 20% of their shares held directly or indirectly by financial institutions or groups. In the life and health sector, such a financial interest is not prohibited but a firm cannot hold itself out as a brokerage firm if more than 20% if its shares are directly or indirectly held by a financial institution or group.

Moreover, when placing a risk with an insurer with which their firm has a business relationship (eg insurer owning shares of the firm), insurance representatives must disclose the relationship to the person with whom they are transacting business.

United States: The payment of inducements and rebates to customers is prohibited; however, providing gifts of de minimis value, such as pens and notepads, may be permitted as long as the distribution of these items is not dependent upon the purchase of an insurance policy.

134. Where conflicts of interest cannot be managed satisfactorily, this should result in the intermediary declining to act.

135. If needed, the supervisor should be able to take action against an insurance intermediary where conflicts of interests are not adequately identified, mitigated or managed.

4.2.3. Handling of client monies

136. Monies held by an intermediary can come from the insurer through claims or refunded payments and/or from the customer for payment of premiums. Where funds are held at the risk of the customer, they may be referred to as "client monies" or "client's money".

137. As required by ICP 18.6, where intermediaries handle client monies they must have sufficient safeguards in place to protect these funds in the interest of their customers.

138. Some jurisdictions disallow or discourage intermediaries from handling client monies, and may require premiums to be paid directly to the insurer by the customer. In other jurisdictions, the handling of client monies is more common. In some cases, it is up to the customer to decide whether they want to pay the premium to the intermediary or directly to the insurer.

Market practices in IAIS Member jurisdictions regarding client monies

In responding to the IAIS survey, several jurisdictions mentioned that such practices are more common for funds related to non-life products. Other jurisdictions make a distinction in terms of the intermediary's status: in some, only brokers may hold client monies, whereas in others it is more usual for agents to do so and can even be forbidden for brokers.

All jurisdictions responding to the survey reported having safeguards in place, which may be either preventive or reactive measures.

139. Preventive measures include segregated accounts and using separate accounts with licensed banks. Most jurisdictions mentioned this measure as a way to avoid mixing client monies with the intermediary's own funds. Some jurisdictions require intermediaries, in order to be permitted to handle client monies, to have been authorised to do so or to be registered as handling client monies.

140. Some jurisdictions impose minimum financial requirements on intermediaries who handle client monies.

Example: France

As soon as intermediaries handle client monies, they must put a financial guarantee in place. In addition, the intermediaries then have to be registered by the ORIAS (intermediaries' official register) as authorized to handle client monies. The minimum amount of this financial guarantee is 115.000€.

141. Reactive measures involve protecting customers in case of an incident; for instance, to ensure that client accounts cannot be used to reimburse creditors of the intermediary in the event of its bankruptcy. In addition, some jurisdictions set up guarantee funds in case of fraud or embezzlement by intermediaries.

142. To protect customers, in some jurisdictions premiums are deemed to have been paid to the insurer as soon as the customer pays premiums to the intermediary. This means that the insurer, rather than the customer, bears the risk of allowing intermediaries to collect premiums on its behalf. However, this generally does not apply the other way around: claims are not deemed to be paid to the customer when paid by the insurer to the intermediary but will have to be effectively paid to the client to be considered as discharged. The insurer remains

ultimately responsible for the collection of premiums and payments of claims through intermediaries.

143. In all cases, adequate financial systems and controls should be maintained and records should be kept and subject to audit to ensure traceability of client monies. The timeliness of payment of funds into client accounts is also important. Some jurisdictions set time limits on this.[41]

4.3. Transparency with customers

144. In order to promote the protection and the fair treatment of customers, it is important that intermediaries disclose specific minimum information about themselves to customers.[42]

145. Disclosure on the intermediary's status enables the customer to identify whether the intermediary is acting as broker or agent (ie on behalf of the customer or on behalf of one or more insurers). This disclosure should enable the customer to understand who is liable for any shortcomings in any advice provided or for other conduct failings by the intermediary. The products that agents can offer may be restricted by agency agreements with the insurer(s) concerned. Disclosure of these arrangements enables customers to consider whether they are comfortable with receiving advice on a limited range of products or whether they may wish to carry out their own research to see whether they can obtain better terms or a more suitable product elsewhere in the market.

146. As there can be more than one intermediary in the chain of the intermediation, appropriate disclosure helps to inform customers of the functions each intermediary performs in the distribution chain.

147. The nature and timing of disclosures may differ according to the circumstances but should be sufficient to inform the customer adequately on their terms of business, their status (ie whether they are acting as an agent of broker), and the relationship they have with the insurer(s) whose products they sell. The information provided needs to be suitable, taking into account the nature of the insurance being intermediated.

Example: Australia

In the context of large-scale natural disasters in Australia, such as the serious bush fires in Victoria in 2009, and the Queensland floods in 2011, ASIC conducted a thematic review of the sale of home insurance. This resulted in the publication of two reports: *REP 415 Review of the sale of home insurance* and *REP 416 Insuring your home: Consumers' experiences buying home insurance*. REP 415 reviews and makes findings in relation to the sale of home building insurance through telephone sales (which included the review of 400 telephone sales call recordings), online sales, online calculators, advertising and promotional materials, and staff training and monitoring. REP 416 presents findings based on qualitative and quantitative research of consumers who inquired about or purchased home insurance during 2013. ASIC's reports demonstrated that the home insurance industry can implement measures that will meaningfully improve consumers' understanding of their policy, and help ensure consumers buy a product that meets their needs.

148. The supervisor may require that, where information is initially provided orally, it should be followed up with written documentation within a reasonable period of time.

149. The mode of communication should make no difference to the quality of information provided, which should be the same for face-to-face and online distribution channels.

[41] For example, in the UK, in accordance with the *Client Asset Sourcebook (CASS),* when money is to be paid into a client bank account, the Financial Conduct Authority expects that in most circumstances it will be practicable for a firm to pay client money into the client bank account by not later than the next business day after receipt.

[42] See ICP 18.5 and related guidance

150. The supervisor should require that the principles of transparency and disclosure, as set out in ICP 18.5, [43] are applied equally to internet, telephonic and other digital insurance activities, as well as to insurance activities through traditional means. For intermediaries who offer insurance products over the internet, certain information should be disclosed on their internet site, such as the contact information for the authority or organization dealing with customer complaints and/or dispute resolution.

151. Many supervisors consider it good practice for the intermediary to retain a copy of the terms of business, as signed by the customer, as acknowledgement of agreement to the terms. In the case of insurance sold over the internet, the customer could be required to acknowledge the terms of business and an electronic record of this retained by the intermediary.

152. Where relevant, terms of business can include the use of mandates under which clients give authority to intermediaries to manage underlying investment assets, specifying to customers the extent of the powers given under the mandate.

153. Disclosure of status may also help customers to identify whether the intermediary has a potential conflict of interest.

4.4. Provision of product information to customers

4.4.1. Product promotion

154. ICP 19.4 requires insurance products and services to be promoted in a manner that is clear, fair and not misleading. This is particularly important because promotional material often provides the first opportunity to a consumer to learn about a product. Intermediaries have a role in product promotion, typically using promotional material developed by insurers,[44] although intermediaries may sometimes develop their own.

155. Regardless of whether the promotional material is developed by insurers or intermediaries, supervisors expect intermediaries to take reasonable steps to ensure that the promotional information they use is accurate and up to date and likely to be understood by the customer concerned. The intermediary's role is primarily to explain the content to customers, helping them to understand whether and how relevant products may be suitable for their needs.

156. If an intermediary becomes aware that promotional material is inaccurate or is misleading, the intermediary should withdraw the material and notify any person that it knows to be relying on the material as soon as practicable. It would be considered good practice for the intermediary also to inform the insurer and the insurance supervisor.

157. Whereas promotional material is often designed to generate customer interest in a product, intermediaries should also ensure that customers are also provided with the formal product disclosure documents required by the jurisdiction. Mere promotional material should not be seen as a substitute for formal product disclosure material.

[43] ICP 18.5.4 provides an illustrative list of information that might be disclosed.

[44] The supervision of insurers with regard to product promotion and disclosure is discussed section 4.3 of the *Application Paper on Approaches to Conduct of Business Supervision*.

IAIS Members were asked about their requirements regarding advertisement by intermediaries

Supervisory requirements on advertising identified by survey respondents included the following:

- Information should be delivered in a clear, understandable manner. Advertisements should not deliver incorrect, misleading or fraudulent information. Nor should they intentionally misrepresent the terms of a contract through incompleteness, or using dishonest practices, untrustworthiness or financial irresponsibility.
- Mailings or other advertisements should disclose the intermediary's name, professional address, registration number and the name of the insurers involved.
- Sales by phone must be recorded.
- Advertisements should not display past performances unless it is clearly stated and accompanied by a warning stating that past performance is not a guarantee of future performance.
- Advertisements require prior authorisation by the insurer concerned.

Some jurisdictions described corrective and preventative measures against inappropriate advertising, such as revocation of a licence, imprisonment, fine, compensation, and injunction.

One jurisdiction described there being no specific requirement on advertisements, but intermediaries are required to comply with the law and regulations against unfair competition.

4.4.2. Product disclosure

158. ICP 19.5 sets requirements regarding the timing, delivery and content of policy information provided to customers at point of sale.

159. Supervisors should require that intermediaries – working with the relevant insurer – take reasonable steps to provide the customer with appropriate information about a policy in good time and in a comprehensible form, so that the customer can make an informed decision about the product before entering into a contract.

160. In determining what is "in good time", an intermediary should consider the importance of the information to the customer's decision-making process and the point at which the information may be most useful. This means customers should be appropriately informed before and/or at the point of sale.

161. The information provided should be sufficiently clear to enable the customer to understand the characteristics of the product they are buying and help them understand whether and why it meets their requirements, without being unnecessarily long or detailed. Key features should be prominent, such as the name of the insurer, policy benefits, policy exclusions or limitations, the level of the premium, the due-date, the period for which the premium is payable, as well as the consequences of late or non-payment. Factors that will influence customers' specific information needs may include:

- the customer's knowledge and experience, given the policy in question;
- the type of policy and its overall complexity;
- whether the policy is bought in connection with other goods and services; and
- whether the same information has been provided to the customer previously and, if so, when.

Example: European Union

Pursuant to article 20 of the new Insurance Distribution Directive of the European Union, prior to the conclusion of a contract, whether or not advice is given, the insurance distributor shall provide the customer with the relevant information about the insurance product in a comprehensible form to allow the customer to make an informed decision, while taking into account the complexity of the insurance product and the type of customer.

This document, referred to as the insurance product information document (IPID) must fulfil some presentation conditions such as, amongst others, to be short, clear, readable, accurate and not misleading, or to be identifiable as the IPID.

According to article 20(8) of the directive, the IPID shall contain the following elements:

a) information about the type of insurance;

b) a summary of the insurance cover, including the main risks insured, the insured sum and, where applicable, the geographical scope and a summary of the excluded risks;

c) the means of payment of premiums and the duration of payments;

d) main exclusions where claims cannot be made;

e) obligations at the start of the contract;

f) obligations during the term of the contract;

g) obligations in the event that a claim is made;

h) the term of the contract including the start and end dates of the contract;

i) the means of terminating the contract.

The standardised presentation format, to be developed by EIOPA (European insurance and occupational pensions authority) will go through a consumer testing exercise.

162. The supervisor may consider there to be an enhanced need for clear and simple disclosure for more complex or investment-related products, particularly regarding the costs and risks involved. For example, in the case of switching from one life insurance policy to another, the customer should be made aware of potential disadvantages of replacing an existing policy.

163. The supervisor should look for evidence that appropriate information has been provided to the customer on a timely basis, taking the above considerations into account. The supervisor could use on-site inspection as an opportunity to verify the adequacy of documentation and record-keeping in this regard.

164. The supervisor may encourage intermediaries to obtain acknowledgements from customers that they have received and understood the information provided. However, for retail customers in particular, such an acknowledgement will not necessarily mean that the customer has fully understood all the terms and conditions, and legal rights and obligations arising from policy and may not on its own be regarded as sufficient evidence that effective disclosure has taken place. Assessing the degree of a customer's understanding of product information can be challenging; the supervisor should be satisfied that product information is presented in a manner that supports the customer's stated interests and helps the customer to understand what they can expect from the product.

165. The supervisor could use approaches such as consumer testing and mystery shopping to determine the effectiveness and adequacy of information provided and the degree to which key information has been explained.

4.5. Advice

166. ICP 19.6 provides that “the supervisor requires insurers and intermediaries to ensure that, where customers receive advice before concluding an insurance contract, such advice is appropriate, taking into account the customer’s disclosed circumstances”. Guidance in ICP 19.6.1 clarifies that advice goes beyond the provision of product information and relates specifically to the provision of a recommendation on the appropriateness of a product to the disclosed needs of the customer. In some jurisdictions, advice (or some form of guidance) is mandatory, either in respect of the whole range of insurance products, or in respect of certain product types of distribution models.

167. Some jurisdictions take this further by providing clear legislative definitions of “advice”. Different categories or levels of advice are also sometimes established, which in turn may be used to differentiate intermediary licensing or competence requirements. These categories may determine the extent of customer needs analysis undertaken before a product is recommended. Other models distinguish between levels of advice based on the complexity of the products concerned, assuming that relatively simpler or lower risk products may be sold through relatively simplified advice processes. The level of information needed on a customer’s circumstances can vary, depending on the type of product and depth of analysis required in providing the advice.

168. In addition to distinguishing between types of advice, many supervisors also set different requirements depending on whether advice is provided or not – for example by setting more rigorous competence requirements for advised sales than for so-called ”execution only” or “factual information only” distribution models. The fact that advice is being provided should be made clear to the customer by the intermediary.

169. Ensuring that records of advice are adequately documented provides valuable protection for both customers and advisers in the event of subsequent disputes regarding the accuracy or suitability of the advice. It also provides the supervisor with useful insight into the competence and diligence of the intermediary concerned, and the quality of record keeping, which the supervisor may wish to check as part of its supervisory review.

4.6. Role of intermediaries during the life cycle of the contract

170. In order to ensure fair outcomes for customers it is important to support the customer not only prior to an insurance policy being entered into, but also during the life cycle of the policy/contract. This is recognised in ICP 19 which sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. Supervisors are increasingly considering the respective roles of insurers and intermediaries in this regard, and how best to ensure that the responsibility for fair customer treatment throughout the product life cycle is appropriately shared between them. The intermediary’s terms of business and how these are communicated at point of sale is an important factor in setting expectations on ongoing involvement of the intermediary after sale of the product.

4.6.1. Ongoing responsibility for disclosure and advice

171. The extent to which supervisors place ongoing responsibility for disclosure and advice varies, and may depend on a number of factors, such as the nature of the product and the intermediary’s terms of business. Where post-sale responsibilities are placed on intermediaries, supervisors should be satisfied that their supervisory tools and frameworks adequately facilitate ongoing supervision of these responsibilities.

- **Ongoing disclosure**

172. Ongoing disclosure is relevant both in respect of the intermediary’s relationship with the customer and in respect of ongoing product disclosure.

173. Where there is an ongoing business relationship between an intermediary and a customer, or in the case of policy renewals, once the terms of business information have initially been provided, the intermediary should regularly review whether reiterating this information is necessary. Further disclosures on these terms might only be necessary where there are changes.

174. Regarding ongoing product disclosure, although this is traditionally seen as primarily the responsibility of the insurer, the role of the intermediary should also be considered, particularly where there is an ongoing relationship between the customer and the intermediary. In some cases supervisors place responsibility directly on the intermediary (over and above any corresponding obligations on the insurer) to provide customers with regular post-sale updates - for example a statement to be provided, usually annually, of the terms and status of the products they initially sold to the customer. Where the terms of business of the intermediary entail ongoing review of the customer's needs and circumstances, this will typically include the ongoing provision of product information to ensure that the product remains suitable to the customer's changing requirements (see discussion below).

> Example: <u>Australia</u>
>
> Australian Financial Services Licensees and their representatives who enter into or have an ongoing fee arrangement with retail clients must provide their retail clients with a fee disclosure statement on an annual basis.

- **Ongoing advice**

175. Depending on the type of product, the customer may need ongoing advice after the initial product sale.

176. During the life of a contract, the customer's circumstances can change, sometimes significantly. Moreover, the financial implications of a product as well as the economic situation as a whole may vary over time. Therefore, some supervisors consider that requirements related to advice apply throughout the whole life cycle of the product. In that regard, the intermediary is encouraged to consider its relationship with customers to be a long-term one and not to focus only on the customer's short-term expectations or only on the short-term incentives for providing advice. This is of utmost importance in the case of policy renewal, for instance.

177. Where the supervisor considers the provision of advice to be an on-going responsibility, this can help to mitigate the risk that reasonable benefit expectations created at the time of sale are not met later. The supervisor may consider setting requirements – at least for certain types of products – regarding the on-going provision of advice for the life of the product. Such requirements could apply to either the insurer or the intermediary. A factor in doing so is that some products may need ongoing advice over a long term, which may exceed the business plan of the intermediary who sold the product.

> Example: <u>Québec, Canada</u>
>
> According to Distribution Act and ethics codes, an intermediary is bound to act with honesty and loyalty in his dealings with clients. He must act with competence and professional integrity. During the period of validity of his certificate, the intermediary must demonstrate availability and diligence with respect to his client or any potential client. He must report to his client on any mandate given to him and must carry out the mandate diligently.
>
> According to these rules, an intermediary must offer a continuing service to his clients. This service depends on the type of products he sold to his client, but it still exists until the contract has expired.
>
> Therefore, an intermediary who, for example, is retiring, and thus is no longer able to meet his obligations pertaining to the follow-up on a policy he sold must ensure that another certified intermediary is assigned to these obligations and, more particularly, provides service to the client.

Moreover, Québec issued a notice[45] reminding insurers and intermediaries that insurance policies must be serviced by duly licensed intermediaries when advice is needed after sale, and that clients must not be left "orphan" when the intermediary who sold the policy retires or otherwise leaves.

4.6.2. Claims management

178. Retail customers often have only limited knowledge about the legal rights and obligations arising from an insurance contract. Although fair claims handling processes are primarily the responsibility of the insurer, some supervisors also expect intermediaries to play a role. For example, in some jurisdictions, before an insurance contract is concluded, the intermediary is required to inform a customer of the right to claim benefits, including conditions under which the policyholder can make a claim and the administrative procedures and contact details to use in submitting a claim.

179. Depending on the type of product or claim concerned and the terms of business, intermediaries may also be required to provide assistance to customers in submitting and finalising claims at the time a claim arises. In many jurisdictions, services related to claims handling are part of the services that intermediaries provide to the customer.

180. In cases where claims settlement is outsourced to intermediaries, such outsourcing arrangements should support the fair treatment of customers. The supervisor will want to be satisfied that any conflicts of interest between intermediaries and claimants are adequately managed – particularly where the intermediary concerned also provides advice. In some cases, restrictions are placed on the types of remuneration that intermediaries who settle claims on behalf of insurers may earn – for instance by prohibiting potentially conflicted profit-sharing type arrangements. Care should be taken to make clear the respective responsibilities of the intermediary and insurer in relation to the claims process, and that ultimate accountability for the correctness and fairness of claim outcomes remains with the insurer.

4.6.3. Complaints handling

181. Before an insurance contract is concluded, the insurer or intermediary, as relevant, should inform a retail customer of their right to complain – including the arrangements for handling such complaints. These should include how a complaint against the intermediary should be made, as well as the relevant insurer's internal dispute resolution mechanism or the existence of an independent dispute resolution mechanism.

182. In accordance with ICP 19.10, the supervisor requires that intermediaries have policies and processes in place to handle complaints in a timely and fair manner.

183. As noted in section 3.4.2, analysis of complaints can be a useful supervisory tool, as this can be an important indicator of the quality of an intermediary's or insurer's conduct of business. Intermediaries may receive complaints that concern either their own conduct or relate to the insurers whose policies they have sold.

[45] "Notice relating to obligations of representatives and insurers with respect to services offered to clients under insurance of persons contracts – Orphan clients" (see: http://www.lautorite.qc.ca/files/pdf/reglementation/distribution/avis/2013may23-notice-orphanclients.pdf).