

Tougher Measures

Stricter regulation for insurance space

BY STEVEN LAMB

Advisors working in the insurance space had better accept the facts: stricter regulation is coming to their industry. But a tougher compliance regime need not be a massive new headache, as managing general agents know; it's also in their interest to keep advisors on-side.

Fortunately, it doesn't look like compliance issues are sneaking up on advisors. According to a recent survey, 88% say that compliance is a much bigger issue than two or three years ago.

On average, advisors in the survey said they had a know-your-client file for 74% of their mutual fund clients – low considering the document is mandatory in the industry. However, in the same survey, advisors stated that just 50% of insurance clients have KYCs.

“When we looked at the type of business, what we saw was that the insurance broker was a little less likely to be KYC-compliant,” said Tricia Benn, director of research for The Advisor Group, who con-

ducted the survey. “Clearly advisors are not all KYC-compliant for mutual funds or insurance.”

Despite such low rates of insurance brokers maintaining proper KYC files, 75% were aware that some provinces require these on segregated fund sales. Nearly two in three (65%) are already making changes to their business practices to keep pace with the regulatory requirements on the mutual fund side of business.

If they were forced to choose an existing regulator to oversee insurance distribution, IDA-licensed advisors (24%) almost unanimously picked the IDA, while MFDA-licence holders were split between that SRO and their provincial regulator.

“Part of the preference for the provincial regulator is, I think, nostalgia for the days before the MFDA came along and started pushing down a heavier style of regulation,” said Bill Donegan, chief legal and regulatory officer, Worldsource Wealth Manage-

ment. “On the MFDA side, we have a national SRO (except in Quebec) which is very strong, and it is pushing IDA-securities style regulation, which is philosophically quite different from insurance regulation, down onto dealers. The dealers, of course, push this down onto advisors.”

Donegan points out that regulation in the insurance channel is quite different, with the carriers regulated by the Office of the Superintendent of Financial Institutions, with provincial insurance regulators overseeing licensing of both the carrier and the agent.

“Most of the carrier agreements push down onto the MGA responsibility for supervision and ensuring that agents are compliant with provincial regulation. The MGA is in a different position from the MFDA dealer, where they are directly in the line of fire for compliance and regulation. It's more of a looser relationship and there are some contractual obligations.

Peter Lamarche, president of Blonde & Little, points out that 40% of insurance advisors are dual licensed and conducting business through a dual-licensed firm.

“On the one hand you have extreme supervision and suitability requirements, and on the other hand there's a vacuum... there appears to be nothing. There is the disclosure document, and that's kind of it, really,” said Lamarche. “I do believe that we have this increased exposure to vicarious liability relationship that we have with advisors.”

Traditionally, he says an MGA thought only of client litigation, but now he says there is some concern there could be an increase in advisor litigation, if the agents feel

that insufficient oversight by their MGA were the cause of a client dispute.

“In the manufacturing industry, accidents and compensation go right to the bottom line. Litiga-

Only 74% of mutual fund clients and 50% of insurance clients have a KYC on file with their advisor.

tion costs come right out of [the MGA's] bottom line.”

“If you think of the three instances that impacted our country in the past few years – Portus, Ian Thow, and Norburg – as MGAs we were involved in all of those things,” he pointed out to the audience. “You just dodged a bullet and you didn't even notice.”

In a conversation with Grant Swanson, executive director of licensing and market conduct for FISCO, Lamarche lamented that in his role as a fund dealer, he was “stuck” between the principles-based regulation of the MFDA and the rules-based system of the OSC.

Lamarche says Swanson's advice provided him with an “a-ha” moment: Forget rules and principles; just manage the business risk. By putting policies and procedures in place to mitigate the risks presented by the clients and advisors that the organization deals with, the firm was “bound to be compliant.”

“We used to talk about the big producer discount, where if the individual had a large book, the dealer would look the other way,” said Donegan. “Recently we've seen the realization that it really doesn't matter how big a producer a guy is; if he causes litigation against your company, the amount

of resources that you have to devote to deal with the issues, is generally way more than you're ever going to make off that advisor.”

While stricter compliance procedures may sound like a waste of time and effort to some advisors, financial statistics clearly favour the closer scrutiny. Donegan points out that the average payout on claims in the mutual fund industry is only around \$6,500. The largest payouts were among complaints over individual life insurance products, where the average cost was about \$23,000.

This discrepancy is even more striking when the frequency of claims is factored in: 61% of claims against advisors were on the investments side of the industry.

“We have more claims on the mutual fund product side, but when we get them on the life side, they cost more to deal with,” says Donegan.

“Most of those figures are less than your deductible,” Lamarche pointed out, “so this is coming out of somebody's pocket, not your E&O carrier.”

Lamarche says it is in the best interests of dual-licensed dealer-MGAs to apply the same standards on the insurance side of their business as they do on the investments side. If an advisor comes to him wanting to place a client in a leveraged mutual fund investment, Lamarche says he can turn them down for any number of reasons as a fund dealer. He questions why the leveraging strategy would be any more suitable if the advisor wants to use a segregated fund instead.

“We judge ourselves by our intentions; others judge us by our actions,” Lamarche said. “How do you want a regulator or a litigious client to judge you?”

IF YOU HAD TO BE GOVERNED BY A SECURITIES REGULATORY STRUCTURE WHICH WOULD YOU PREFER?

	2008 n = 483 %
Provincial securities regulator	40
MFDA	31
IDA	24
No Answer	5